

Final Report

The Evaluation of Macroeconomic and Fiscal Assistance to Ukraine



SUBMITTED TO
USAID/Ukraine

SUBMITTED BY
Nathan-MSI Group

UNDER CONTRACT
PCE-I-811-98-00016-00

May 23, 2000

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Glossary

CASE	Center for Social and Economic Research
E&E	USAID Washington Bureau for Europe and Eurasia
FAO	Fiscal Analysis Office (of the Verkhovna Rada)
GDP	Gross Domestic Product
GNP	Gross National Product
GOI	Government of Indonesia
GOSPLAN	Central planning office in the former Soviet Union
GOU	Government of Ukraine
HIID	Harvard Institute for International Development
IAS	international accounting standards
ICPS	International Center for Policy Studies
IFI	International Financial Institutions
IGR	intergovernmental fiscal relations
IMF	International Monetary Fund
IQC	indefinite quantity contract
IR	intermediate result
IT	information technology
MOE	Ministry of Economy
MOF	Ministry of Finance
NGO	nongovernmental organization
OYB	operating year budget
PIT	personal income tax
SO	Strategic Objective
STA	State Tax Administration
TA	technical assistance
TACIS	European Community's Technical Assistance to the Council of Independent States
TOR	Terms of Reference
VAT	value added tax

Preface

The following report, an Evaluation of Macroeconomic and Fiscal Assistance to Ukraine, has been prepared following a month-long evaluation of USAID/Kiev's five-year technical assistance program to improve fiscal policies and fiscal management practices in Ukraine. The Barents Group, in conjunction with the Harvard Institute for International Development has been contracted to implement this program.

The evaluation was conducted under SEGIR-GBTI contract no. PCE-I-811-98-00016-00, with a three-person study team including Mr. Paul O'Farrell (Team Leader/Macro Policy Specialist), Mr. Samuel Skogstad (Tax Reform Specialist), and Mr. Thomas Bertone (Budget Reform Specialist.)

The authors wish to express their appreciation for the assistance provided by USAID/Ukraine, the IMF and the World Bank, and for the information and cooperation of the Government of Ukraine's Ministry of Finance, Ministry of Economy, the Treasury and State Tax Administration, and others.

1. Introduction

As background to the evaluation of macroeconomic and fiscal assistance to Ukraine, it is useful to review the larger context in which the technical assistance is taking place. Ukraine is experiencing the aftermath of the collapse of the Soviet economic system. Today a nascent and not well-organized group of reformers is trying to shift the economy to the principles underlying advanced western economies. In other words, people, in their pursuit of happiness in the material world, ultimately base their choices on the relative scarcity of resources; individuals must be free to pursue their choices; and choice is based on the value of resources measured by the tradeoffs associated with their use.

Not all Ukrainians are intellectually or operationally engaged in the reform effort. In fact, the reform has stalled several times since independence. Today, there are probably only a few who do not yet appreciate the inevitability of failure under the former system and remain in opposition to the reform. More, however, understand the failure but have not grasped the alternative. Some try at a micro level to preserve their status or benefits. Others may be merely taking advantage of the chaos for personal gain. It is likely that the majority of Ukrainians want to see their country and themselves prosper but have no skills or experience to contribute to the reform. In a sense, they are dead weight for the reformers. Yet they are also the pool from which the reform must get its support and workforce. The longer they remain unable to contribute to the reform, the longer the reform will take. In the meantime, they could be attracted to ideologies or personalities that are not supportive of the reform.

While reform is rarely an imperative before a crisis, the speed, depth, and extent of the collapse has severely complicated the Ukrainian effort. The economy-wide breakdown of the state-managed system of production and distribution has resulted in an economic depression significantly worse than that experienced by the United States during the Great Depression. Policy instruments available to a market economy to stimulate growth do not yet exist. Until recently, government policy was directed as much at a futile effort to cushion the collapse and thus prolong the transition as to create the proper environment for new, market-based activity.

As the prohibition on private enterprise and the enforcement of the state-managed system ended, a new market economy began to emerge. The government, however, has not yet capitalized on this development to provide the expansion needed to restore the economic well being of the country at large. Yet-to-be-dismantled elements of the former system and heavy handed measures associated with reform legislation not only constrain the emerging market economy, but also have forced much of it into the shadows, further denying its benefit to the government reform effort.

The challenge in Ukraine can not be overstated. Having operated for the past 83 years under a system that proved unsustainable, Ukraine must discard the residual concepts, policies, and structures of its old paradigm and create the new ones appropriate for a market economy. This is a problem of transformation from one complex system to another. It is not like promoting economic development in "Third World" countries. In developing countries, external assistance seeks to build a base of skills and institutions where little existed before. In the Ukraine, external assistance must operate in an

environment that has been highly developed for the needs of the old paradigm. This is not a subsistence agricultural economy. Rather it is a wrecked industrial economy. The unskilled in this economy are not unskilled. Rather, they have a highly developed set of the wrong skills. Similarly, key institutions are not missing; they are still engaged in the wrong tasks.

The reform movement in Ukraine does not have to go-it-alone. With years of experience with the market economy, foreign donors are providing experts to transfer knowledge and experience. Cohesion exists within the overall assistance effort. Principally, this takes the form of a division of labor among the international financial institutions (IFI) and other donor organizations. The broad macroeconomic fundamentals are the focus of the International Monetary Fund (IMF). What might be termed “sectoral” issues are the focus of the World Bank. Woven into this fabric are the activities of the bilateral, regional, and nongovernment donors who provide on-the-ground assistance.

There is no rigid hierarchy in this arrangement or sharp line dividing macroeconomic issues from sectoral issues. Specific assistance activities provided by all parties form a generally integrated whole. But, insofar as each institution and donor has a particular corporate culture or experience bias, its experts, to some extent, reflect these differences. In addition, each donor has its own vision of its long-term relations with Ukraine. These differences can result in duplication, overlap, and conflicting advice. Nevertheless, these problems appear to be minimized by close coordination among the assistance providers both outside and inside Ukraine.

PURPOSE OF THE EVALUATION

The transformation of Ukraine’s economy depends in significant ways on government leadership and management. The speed of the transition is heavily dependent on the speed with which the government withdraws from its remaining involvement in state ownership and control of important elements of the economy. New economic expansion is heavily dependent on the time it takes for the government to reorganize its institutions and retrain its personnel to be compatible with the needs of a market economy. Finally, the long-term health of the new market economy depends on the competence of government policies in fiscal and monetary matters and in promoting a competitive market environment.

U.S. assistance to Ukraine is being provided to help solve a large number of problems associated with the transition, both inside and outside of government. Primarily, it is helping to develop the institutions and human resources that will be needed during and after the transition. This evaluation focuses on the components of the overall U.S. assistance directed at supporting macroeconomic and fiscal reform. Not only is this portion of U.S. assistance aimed at better policies and specific macroeconomic targets in the short run, but it also seeks to build the government’s capability to analyze, formulate, and implement new policies in these areas as they are needed.

The objectives of this assistance are well defined in USAID/Kyiv’s Strategic Plan under Strategic Objective 1.2 (SO 1.2). SO 1.2 seeks increased soundness of fiscal policies and fiscal management practices. The specific areas of assistance under this SO are (1) tax policy, (2) tax administration, (3) budget processes and treasury management, (4) fiscal analysis for the parliament, (5) intergovernmental finance, and (6) public administration reform. While there is no specific macroeconomic subcategory under SO 1.2, assistance to and improvement of the macroeconomic environment is implied through the SO.

This evaluation seeks to determine the extent to which the assistance provided since 1997 conforms to the plan of SO 1, has been valued and utilized by the Government of Ukraine (GOU), and has been effective in achieving its targets. Based on the findings, the evaluation will recommend areas for future assistance under several budget scenarios.

DESCRIPTION OF THE ASSISTANCE ACTIVITIES

The assistance activities provided to the GOU under SO 1.2 are, to some degree, encyclopedic. Although they are all organized under the various sub-elements of SO 1.2, the nature of the problem as well as the approach required to make the assistance effective result in a large number of technical assistance and training interventions with a relatively large number of counterparts. While individual advisers, as in the case of U.S. Treasury experts, or a group of advisers, as in the case of the Harvard Institute for International Development (HIID), Barents, and the Center for Social and Economic Research (CASE), have specific senior government counterparts, the advisers interact with, assist, and train a larger body of Ukrainians who form the staffs of the counterparts. In addition, the advisers interact with, and in a number of cases assist, emerging nongovernment groups engaged in policy analysis and advocacy.

It is the unqualified judgment of the evaluation team that USAID/Kyiv's management oversight and documentation of the evaluated activities are among the best we have seen. USAID/Kyiv's project management unit maintains comprehensive information that describes, tracks, and assesses each of the technical assistance actions under the various contractors and other providers. This information will not be repeated in this report; the assistance providers will be described more in terms of their approach and emphasis as perceived by the evaluation team.

Harvard Institute for International Development

HIID operates in Ukraine under a cooperative agreement with USAID. Such an arrangement allows HIID a greater degree of freedom to determine its activities and emphasis than that afforded to a USAID contractor. Consequently, HIID sees its mandate as providing advice, analysis, training, and encouragement to those engaged in the economic transformation inside and outside the GOU. This places HIID in more of a public policy think tank role than that afforded contractors providing assistance. HIID is largely free to choose where it wants to direct its efforts and is able to shift its emphasis as it feels conditions warrant. HIID pointed out, for example, that in the early years of its effort in Ukraine, the group sought to cultivate clients among government policymakers. On the basis of its experience, HIID gradually shifted to emphasize outreach to nongovernment entities and training of younger generation policy analysts.

On the government side, HIID remains engaged to provide a range of analysis and advice to the GOU as requested. HIID has tended to concentrate its effort in the Ministry of Economy (MOE). The MOE, formerly GOSPLAN, is, among other things, responsible for monitoring and evaluating economic conditions, forecasting future trends in GNP and its components, and strategic planning. Each of these functions is viewed as essential to the government's pursuit of reform. HIID provides analysis, advice, and on-the-job training to the MOE through the first deputy minister in charge of policy-related functions. HIID advisers not only work directly with the deputy minister, but also interact significantly with the staff in the various offices that report to him. HIID reviews and

comments on various documents under preparation by the MOE. It also provides the MOE with its own research and analysis on important general and specific policy issues. It has conducted training classes for the ministry staff and provides supplementary staff to the ministry under its intern program.

HIID provides its services to other key reform elements of the GOU. For example, before the government's reorganization of functions, HIID provided tax policy advice to the State Tax Administration (STA). With the STA, HIID also analyzed issues in taxation and revenue generation and helped in the area of forecasting. Under administrative reform, HIID is now working on a paper for the STA that will describe the organizational structures of tax collection agencies in advanced western economies.

With the transfer of tax policy responsibility to the Ministry of Finance (MOF), HIID has more recently directed its efforts on this topic to this ministry. HIID has also provided its views on proposed budgets and has carried out a comparative analysis of the past five annual budgets. The MOF is further supported with staff training courses and staff augmentation through the provision of two HIID interns.

The central bank was the counterpart for HIID's study of the health of the banking system and is now awaiting HIID's completion of its study of land markets. Both the Ministry of Labor and Social Policy and the Pension Fund were counterparts for HIID's work on pension reform.

As noted above, HIID has increased its emphasis on activities that it terms capacity building, indirect policy support, and data gathering and research. In the area of capacity building HIID collaborates with the Graduate Program in Economics at the Kyiv-Mohyla Academy and provides opportunities for internships within the program in Kyiv, and, in some cases, arranges for further study abroad. These recent graduates are mentored by the more senior HIID experts and are involved in work on the actual policy issues of concern in Ukraine today. HIID has placed a number of interns within the various ministries that it assists.

On a more publicly visible level, HIID sponsors a regular program of discussion seminars in which important and timely policy level issues are presented. The audience is usually well over 100 people consisting of senior government officials and nongovernment reform-minded intellectuals. HIID sponsors well-known international experts to speak to the Ukrainian reform community inside and outside the government. In addition, HIID publishes weekly, monthly, and quarterly reports on the economy and distributes these, along with data tables and recent research papers, to a broad mailing list in Ukraine and abroad. At present, the list contains more than 500 names and includes Ukrainian academics who otherwise would have difficulty in their own research if the HIID data were not available.

Center for Social and Economic Research

CASE is under contract to provide direct technical assistance to the MOE in the area of macro-economic modeling and forecasting. The MOE provides the official forecasts of GNP and its components, numbers that are used by numerous entities in the government engaged in the reform effort. Of particular importance, the MOF uses the GNP forecasts for revenue projections. (Although this process is bringing more reality to the tax revenue forecasts, the evaluation team was told that

certain groups in the Council of Ministers and in the Verkhovna Rada may continue to inflate the tax and non-tax revenue forecasts for political reasons during the budget approval process.)

CASE has spent considerable time developing the data gathering and interpreting skills of the MOE and has introduced a basic econometric model of the economy. The evaluation team was told by the First Deputy Minister of the MOE that the forecasts produced by the CASE model were the benchmark for all other forecasting work going on in the Ministry.

U.S. Department of Treasury Macroeconomic Adviser

The U.S. Department of Treasury has placed one macroeconomic adviser to serve as counterpart with the Deputy Minister in the MOE responsible for preparing the GOU's annual plan, strategic planning, forecasting, and overall monitoring of the economy. The adviser is located in the ministry and has a close working relationship with the Deputy Minister. He is assisted by an assistant/translator and can draw on short-term assistance from Washington if needed. As a confidential adviser to the Deputy Minister, he is engaged in nearly all work that comes across the Deputy Minister's desk. He is particularly involved in helping the Deputy Minister reorganize and strengthen his staff and has facilitated HIID's and CASE's assistance to the various departments under the Deputy Minister's control.

RAND/International Center for Policy Studies

While not a focus of this evaluation, the activities of RAND/ICPS should be mentioned. The two organizations were teamed up to conduct a series of seminars for mid- and upper-level public officials on a variety of topics to improve their skills in operating on a policy level. Records available to the evaluation team indicated that the topics included the budget process, the role of government in a market economy, and program evaluation. These seminars brought together people who needed to coordinate their activities but found it difficult within the existing structure of the bureaucracy.

Barents

Barents began providing fiscal reform technical assistance under a regional contract issued in 1995. This initial phase focused on the establishment of a fiscal analysis unit within the Budget Department of the MOF to work on macroeconomic analysis and revenue modeling, database development, and budget reporting. USAID withdrew from the macroeconomic analysis and revenue modeling activities in 1996, because it felt that the counterparts did not want to grapple with some of the basic issues (e.g., data problems), and a number of other donors had entered the field. Thereafter, USAID concentrated more on providing assistance for budget preparation and on new activities in the tax administration area.

By 1998, this initial phase was judged to be successful enough for USAID to issue a competitively bid Omnibus Task Order to continue the work. This process was also required because the E&E Bureau's regional fiscal contract with Barents had been fully obligated. Barents won the Omnibus Task Order competition and began the next phase on September 30, 1998.

Under the task order, Barents operates in accordance with the usual USAID project management structure. Consequently, the task order specifies a series of tasks to be fulfilled, and the Barents

proposal is organized around those tasks. The task order also specifies a series of tangible results/benchmarks and states that USAID will judge the contractor's success on "...whether or not the Tangible Results or Benchmarks are achieved...". The progress reporting system for this technical assistance then incorporated the tangible results into the semester reporting format, although adjustments were made to allow for slippage in results, reduce the length of the presentation, and to accommodate changing circumstances.

Tax Policy and Administration

Tasks 1 through 4 in the Barents Task Order deal with (1) tax implementation and collection, (2) enforcement, (3) tax modeling and revenue forecasting, and (4) computerization of tax administration. These components constitute almost 60 percent of the total Barents budget. As the task order makes clear, most of this (40 percent) represents assistance in tax administration. A precise division between administration and policy cannot be made, as the team members who assist the GOU with tax legislation deal with both administrative and policy aspects of the law. Of Barents' 23 professional staff members (about two-thirds of these are local Ukrainian professionals), only three—two Americans and one Ukrainian—are explicitly identified as tax policy specialists.

But, the group working with the Verkhovna Rada includes an economist working on such issues as "tax assignment and tax sharing," which are certainly a significant elements of tax policy. Overall, it seems reasonable to consider something in the neighborhood of 10 to 15 percent as the portion of the Barents budget addressing tax policy.

This allocation of the work and the budget is particularly interesting, because the Barents contract represents by far the largest expenditure of U.S. economic assistance funds in support of reforming the tax system. The benchmarks reinforce the conclusion that this contract places little emphasis on the reform of tax policy. In a subsequent section, we address the issues raised by these allocations. The evaluation team hopes that this allocation of resources reflects the absorptive capacity of the GOU in tax policy vis-à-vis other demands on the funds rather than a view that the U.S. Treasury should carry the load in this area. After 10 to 12 years of assisting Eastern Europe and the states of the former Soviet Union, it should be plainly evident that the comparative advantages of the U.S. Treasury and USAID in fielding complementary technical assistance is a valuable aspect of U.S. foreign assistance.

The three tax policy specialists serve the Ministry of Finance, along with two legal advisers whose efforts are mainly in the area of tax administration. Seven Barents advisers work on tax administration issues in the State Tax Administration (STA). Three of these are information technology specialists. The tangible results/benchmarks in the task order are shown in Exhibit 1. As can be seen from the exhibit, we judge that even the modest policy agenda set forth in the task order has not been realized to a significant degree. We caution that failure to achieve the objectives does not necessarily reflect badly on the contractor, on the individuals assigned to the tasks, or on USAID management. To a significant degree, it might be concluded that the Ministry of Finance and policy leadership above it have not been forceful in their resolve to develop an appropriate and complete set of tax laws and present these persuasively to Parliament for enactment.

The Barents advisers on tax policy working with the MOF do not appear to have any close counterparts with whom they are working with on a daily basis, and it is not clear that their advice,

Exhibit I. Distribution Of Expected Tangible Results—Tax Policy and Administration

Results Expected in First Year

Benchmark	Result
Tax Policy	
1. New tax reform laws on PIT, excise taxes implemented, and taxpayer information programs prepare tax service and public for the implementation.	Not achieved; law not passed
Tax Administration	
2. (a) Provide informational materials and taxpayer education on VAT and EPT.	Achieved
(b) Prevent extension of suspension of instituting "international standards."	Achieved
3. Computerized tax information systems revised for use in improving tax administration and tested in Kiev Oblast.	Not Achieved In Oblast
4. Provide further assistance in introducing modern tax audit techniques including computerized audit selection. Increase returns from fewer audits.	Achieved
5. Provide training in international accounting standards and promote conversion of enterprises to IAS.	Achieved

Results Expected in Second Year

Benchmark	Result
Tax Policy	
1. Major laws (VAT, EPT, PIT, Excises and Admin. Law) implemented via a "single consistent tax code."	Not yet passed into law
2. Macroeconomic forecasting models are developed for use by the MOF and potentially the Rada's Fiscal Affairs Office (FAO) to develop "realistic budgets."	Not under Barents control
3. Rada FAO made official analytic arm of Rada and advise budget and tax committees on proposed tax law changes, and their effect on growth.	Used but not institutionalized
Tax Administration	
4. Appropriate regulatory framework put in place to implement new VAT and EPT, PIT, excise taxes, and administrative law.	Not achieved; law not passed
5. Computerized taxpayer information and collection systems further developed, initially in Kiev Oblast, and plans underway for nationwide extension.	Achieved by IMF
6. Modern audit techniques are being introduced, including computerized audit selection and combined audits of all taxes paid by an enterprise.	Substantially achieved
7. Tax enforcement "activities" improved, and "efforts made" toward equitable treatment.	Achieved
8. Taxpayer information centers established and education encourages voluntary compliance.	Achieved

no matter how technically sound it may be, has an audience. It appears that they react quickly and effectively to specific requests. But they do not seem to be allowed to lead a policy reform effort. Thus it appears that there is neither strong demand for effective advice to senior policymakers, nor institutional development in the form of training Ukrainian analysts in the alchemy of tax analysis. Toward the end of this evaluation, some activity on the part of the GOU suggested that government

interest in tax policy may be rising and an institution to develop such policy may be soon put in place.

The foregoing comments relate primarily to the indicators set out in the task order. We emphasize that, despite the seemingly negative evaluation against those criteria, we believe the Barents team has produced some excellent work that has been valuable and helpful in producing the slow, but significant, progress that has been made in the realm of fiscal management since the first western advisers arrived. Is this an irony? No.

We believe that the negative evaluation of the task order requirement is attributable to the rigidity in USAID-wide project documentation and management requirements. These requirements seem to be modeled after project management requirements engineers adhere to for the erection of buildings or bridges. Such projects require execution of tasks that are precisely specified in advance, and their success depends only on the operation of the laws of physics, providing the blueprints are followed exactly. The success of economic policy technical assistance, by contrast, depends on the laws of human behavior, in which human volition appears to play a role. In a socio/political/economic environment in which there are frequent changes in the reactions of human beings to the incentives and disincentives that motivate them, yesterday's fine plan can quickly be converted into today's garbage bag. In such volatile circumstances, a technical assistance project must be subject to a rolling design that changes as the rules of the game change. If a politician could enact a revocation of the law of gravity to gain a pecuniary advantage, is it not likely that he or she would do so? And would we not then have to go back to the drawing board to get a workable plan for the erection of our building?

The fact that slow, but significant progress in tax policy has been made reflects USAID/Kyiv's and the U.S. Treasury's willingness to focus the technical assistance effort on the strategic objective rather than the specific task made temporarily inappropriate by circumstances in the GOU.

Other Fiscal Reform Areas

This section covers Tasks 5 through 8 in the Barents Task Order related to budget process and treasury systems (5), revenue forecasting and fiscal analysis (6), intergovernmental finance(7), and public administration reform (8). To perform against the expected results in these four areas, Barents assembled two teams, supplemented with short-term specialists as required. One team is housed in the Ministry of Finance and concentrates on assistance to the Executive Branch, primarily the Ministry of Finance, including the Department of Treasury, with some assistance to the Ministry of Economy. The second is housed separate from but close to the Verkhovna Rada and concentrates on assistance to the Verkhovna Rada.

It is important to recognize that each of the teams is charged with producing technical outputs. Consequently, they are staffed with technical specialists who can produce technical outputs. They are not staffed with ex-senior officials of government who could act as policy advisers to Ukrainian decision makers and managers. Neither do they have counterparts with whom they sit, with whom they work on a daily basis, and to whom they provide technology transfer. As positioned, they can only produce technical material, explain that material to the potential Ukrainian client user, and assist in the implementation and use of that material, if requested to do so by the client. As staffed and positioned, neither team should be held accountable if the client does not choose to use and

implement outputs (although several of the expected results read as if the teams are to be held accountable).

The evaluation team has reviewed the expected results and outputs and their disposition to date and concludes that, of 16 tangible results expected between the beginning and end of the task order period:

- Seven have been achieved;
- Two have been partially achieved;
- Six are in progress; and
- One is no longer applicable.

Exhibit 2 shows the distribution of these accomplishments. Shortfalls in performance are attributable not to the lack of technical output production but to the clients' lack of readiness to accept, implement, and use the outputs. Moreover, when the evaluation team asked for outputs and budgets associated with the tasks, the response was that the Barents contract is not being managed so precisely. Rather than focusing on the production of specific outputs, the Mission is more interested in progress toward the Strategic Objective and Intermediate Results. As a result, both Barents and the Mission have been pursuing a strategy of identifying and orienting the project toward targets of opportunity that promote the accomplishment of the SO and IRs.

On this basis, the evaluation team observes that in each of these tasks Barents has produced outputs of acceptable quality and quantity and that, according to interviews conducted, has provided substantial and valuable technical advice. We note further, however, that of total financial resources available to Barents, only 1.2 and 1.5 percent have been devoted to treasury management and public administration reform, respectively. Related to the treasury, Barents may have played a crucial role but probably not a major role in the progress made.

Public administration reform was undertaken earlier under a separate task order pursuant to an indefinite quantity contract (IQC) that allocated \$250,000 to \$300,000 to this activity. This funding was used to support the functional review and restructuring of the MOF and the MOE, including an initial consultant study and follow-up study tours (to Poland and Estonia) and advisory visits from Polish officials. The provision in the Omnibus Task Order was intended to allow continuation of follow-up assistance as necessary. Given delays in utilization of the initial funding and efficient use of that funding within the region, it is only recently that the Task Order funding has started to be used for this purpose.

When expected results, resource utilization, and progress toward Intermediate Results are all considered, the evaluation team concludes that Barents played a major role in progress toward the Strategic Objective with regard to (1) the budget process in the MOF; and (2) fiscal analysis in the Verkhovna Rada.

Exhibit II. Distribution of Expected Tangible Results—Non-Tax Fiscal Reform

Results Expected in First Year

Benchmark	Result
Budget Process and Treasury System	
1. Changes approved in the budget classification system law to allow full conformance with international standards are implemented in the context of the 1999 budget and the Treasury chart of accounts.	Achieved
2. Assuming enactment, comprehensive budget law is implemented for all aspects of the budget process, with assistance from advisers.	Not applicable
3. Budget preparation procedures are further developed, including training for spending ministry staff involved in budget preparation and introduction of program evaluation and analysis techniques are for a few key programs. As a result, 1999 budget is more realistic and makes more efficient use of funds for programs evaluated.	Partial
4. Training assessment for the Treasury is followed up by help with meeting specific training needs, as requested.	Achieved
Revenue Forecasting and Fiscal Analysis	
5. In cooperation with other technical assistance providers, work on improvement in data availability and data quality, including as feasible development of a common economic database with agreement on participation by the MOF, MOE, State Statistics, and National Bank of Ukraine.	Achieved
6. The Fiscal Analysis Office staff are trained and are providing analyses of tax and budget measures to the relevant Verkhovna Rada Committees on a regular basis.	Achieved
Intergovernmental Finance	
7. Substantial work is done on defining alternative fiscal arrangements between central and local governments and their implications and on drafting local government finance legislation for consideration by the Verkhovna Rada.	Achieved
Public Administration Reform	
8. Organizational changes to the MOF Budget Department and other departments of the MOF and MOE are under way, based on recommendations of functional reviews.	Achieved

Results Expected in Second Year

Benchmark	Result
Budget Process and Treasury System	
1. Budget preparation techniques are refined to enable the MOF to increase the accuracy of budget estimates, meet the information requirements of the Cabinet of Ministers, the Parliament, and conform to international standards.	In process
2. Support provided to the Treasury as requested assists in further implementation of the treasury system in conformity with the condition of the World Bank loan.	Achieved

Exhibit 2 (continued)

Benchmark	Result
3. Macroeconomic forecasting models are developed for use by the MOF and potentially the FAO in efforts to develop realistic budgets.	In process
Revenue Forecasting and Fiscal Analysis	
4. In conjunction with the World Bank and other donors, a common macroeconomic database that gives access to data readily available in most market economies is developed and maintained for the MOF, MOE, State Statistics, and National Bank; this database is used to improve economic policy and macroeconomic forecasting in Ukraine.	Partial
5. The FAO is designated officially as an analytic arm of the Parliament, similar to U. S. Congressional Budget Offices/Joint Tax Committee, and advises the budget and tax committees on proposed budgets and tax law changes and their potential impact on government activities and economic growth. It also provides analysis to other committees of the Verkhovna Rada upon request as resources permit.	In process
Intergovernmental Finance	
6. Alternative fiscal arrangements between central and local governments are developed to enable better financial planning by the central government and greater fiscal autonomy and accountability for local governments. Recommendations are made for strengthening budgeting and financial management at the local government level.	In process
Public Administration Forum	
7. Organizational structure and functions of the MOF, MOE, and STA are clearly defined and modernized, with obsolete functions eliminated.	In process
8. Component departments such as Budget and Treasury are appropriately staffed with sufficient expertise to carry out their functions.	In process

2. Findings

MACROECONOMICS^{3/4}A DIFFERENT BALL GAME THAN IN THE PAST

Traditionally the term macroeconomic policy referred to government management of certain broad aspects of the overall economy such as the balance between aggregate supply and demand, consumption and savings, savings and investment, growth, and debt. In managing these issues, macroeconomists focus on the behavior of prices, interest rates, the value and stability of the currency, the country's overall debt situation and its management, its banking system, the budget and how it is financed, and the rate of GDP growth. The best advice for a market economy that has serious imbalances at the macro level may be more closely related to common sense than sophisticated economic analysis. But, in fine tuning an advanced market economy and in assessing the consequences of fundamental shifts in policy, rigorous economic analysis is essential to policymakers.

Ukraine and the other states of the former Soviet Union and Eastern Europe present macroeconomists a new problem. The evaluation team was often told by Ukrainian officials that they had enough common sense to know what their demand management program should be. They knew they had to reduce the public sector's claim on total resources, finance their budget in noninflationary ways, ensure market-relevant real interest rates, reduce foreign borrowing to a manageable level, ensure the convertibility of the currency, and strengthen the banking system. However, an important reason for their not achieving program targets is that they do not have the prerequisites required to manage macroeconomic policy. For example, when the economy collapsed in the early 1990s, they could not finance their budget through taxes because they lacked the tax instruments and the legal and institutional basis to establish liabilities for taxes. They could not effectively track or match expenditures with revenues because there was no real central budgeting process and treasury. Not only did they lack the prerequisite instruments and institutions, they lacked the personnel who knew how to develop them.

This problem has forced the donor institutions into a new method of operation. In particular, the IMF, which traditionally deals with problems under the purview of a minister of finance and the governor of the central bank, now finds itself in Ukraine performing a far wider analysis of the economy's problems. It finds itself including in its recommendations and conditionality policies, processes and legislation that traditionally were the realm of the World Bank and the bilateral donors. As the IMF conditions illustrate, advice now includes a detailed agenda of very specific measures in very specific areas of the economy.¹

¹ It should be said, however, that this did not arise exclusively from the situation in Ukraine and the other former Marxist/Leninist states. The IMF Board of Directors has been urging the IMF for some time to broaden its analysis and involvement in supporting a country's economic reform program.

Achievements

Achievements of the macroeconomic reform effort are the subject of substantial discussion and debate. Ukraine officials believe that substantial progress has been made, and they particularly point to several reforms. For example, they point to their control of inflation, significant improvements in their ability to manage the budget, the two modern tax laws that have been passed, and their significant reform of the government by eliminating old line ministries and strengthening the cabinet to focus more on economic policy management and less on the management of production and distribution. It should also be said that there is a positive “let’s get the job done” attitude among the GOU counterparts that we met. They speak of a new presidential commitment to reform, an activist, reform-minded prime minister, and a parliament that, for the first time since independence, is not controlled by the old guard.

Individuals on the donors’ side seem to be divided into two schools of thought. One group believes that the reforms to date are not as significant as the GOU claims and conditions are continuing to deteriorate. They also are not convinced that there has been a turn-around in the GOU’s political reluctance to aggressively pursue reform. The second group acknowledges some degree of truth to the GOU’s assessment and is willing to give the GOU another chance.

Two facts should be considered. First, the accomplishments the GOU lists did occur. Second, the economy is still not healthy. Although a small amount of economic growth has been reported for the first quarter of 2000, it is not clear if this is a real turning point, a symptom of faulty data, or a transition phenomenon. The question of whether more could have been done since independence is academic. The question of what will happen in the future is speculative. If one believes that the GOU achievement is weak and the future is gloomy, one must conclude that the U.S. assistance provided during the period was either a mistake, inept, or overwhelmed by the old guard. If one has a more positive view of the situation, one must now face the question of whether the advisers provided by the United States made a difference and how assistance should be provided in the future.

With the overarching presence of the IMF and the World Bank as well as the involvement of other donors and NGOs, it is difficult to explicitly identify the unique contribution of the macroeconomic assistance provided by the United States. On major policy issues, there is general agreement on the advice provided by the principal macroeconomic advisers. Which one said the magic words to the GOU that resulted in movement along the reform path is almost impossible to say. All of the macroeconomic advisers engaged in a particular Ukraine reform see their influence and claim responsibility when the outcome is positive. It is hard to interpret the GOU’s views on the technical assistance they received because they claim credit for the reform activities themselves, in many cases claiming that they got little help from advisers. Both the IMF and the World Bank were quite blunt in stating that they are defining the reforms and the GOU is following their lead. They recognize that the United States and other donors play a role in later implementation. But they are not prepared to say that they had any dependence on the U.S. macroeconomic assistance in their formulation of the program. We were told in one instance that U.S. macroeconomic assistance was irrelevant and in another that it was overlapping and unhelpful. Finally, TACIS, the European Union’s assistance agency, told us that the most important influence was Ukraine’s desire to join the EU.

The perception among the international financial institutions and GOU counterparts is that HIID is the main U.S. provider of macroeconomic advice and CASE, Barents, and the U.S. Treasury advisers are technical and process-oriented. In fact, all of these groups are involved at a policy level in the macroeconomic program in Ukraine. But the method of operation and the visibility of each is quite different. HIID operates through a “study and presentation” approach. A topic is generally identified with a counterpart. A group, including some GOU staff, is organized to investigate the topic. When the analysis is completed, the findings and recommendations are presented to the senior counterpart and often to others through seminars and the HIID mailing list. In some cases, HIID’s analysis has stimulated considerable public discussion within the Ukrainian and expatriate pro-reform community.

In contrast to HIID, CASE, Barents, and the U.S. Treasury advisers, are more specifically targeted to a particular counterpart, and their analysis and advice are considerably less visible to those outside the government department in which they are working. The macroeconomic advice provided by these three groups is mainly, but not exclusively, embodied in the processes they are developing and the training they are providing. In the case of Barents and the U.S. Treasury advisers, analysis and recommendations provided to their clients are kept confidential. Although CASE has been more visible, its highly technical focus on data and modeling is not the kind of topic that stimulates a lot of public debate.

Several schools of thought are evident from our conversations with the international organizations, the GOU, and others with whom we spoke. The IMF, while not openly critical of most of HIID’s analysis, was uncomfortable with HIID’s activity. They see HIID as a competitor on some issues and they question the value of some aspects of the public nature of HIID’s findings and recommendations. They particularly pointed out HIID’s tax reduction recommendation and the publicity surrounding it as an example that they believe makes their job more difficult. In addition, the IMF was upset about the newspaper article written by one of HIID staff that non-performance on IMF conditionality be ignored for a year. Both the IMF and the World Bank suggested that the process and training technical assistance as provided by Barents was more compatible to what they saw as their lead position in advising the GOU on reform.

Government interlocutors appreciated the work HIID was doing in data collection and regular economic reporting. The team reviewed a sample of this material and found it of high quality. Government officials also appreciate reading the specific analysis done for them by HIID and the comments HIID provided on documents that they sent for review. However, at the senior level, they also felt a strong need for more in-house advisers who were more specifically tasked to strengthening their respective departments, although the staff level of the MOE’s department of strategic planning felt that HIID had provided valuable training.

The U.S. Treasury macroeconomic adviser was pointed to as a good example of the kind of in-house adviser his counterpart wanted. However, the official added that this person should be supplemented by a meaningful level of staff training to develop capacity within his office. He added that he appreciated HIID’s suggestions, but at the end of the day, his office’s products were produced by his staff who still lacked sufficient skills to prepare them correctly. One interviewee expressed the view that the foreign advisers who studied Ukraine’s problems may take more knowledge away from Ukraine through their research than they leave behind through training. The value placed on a

confidential “back room” group of analysts and advisers was often repeated particularly at the parliament.

With regard to modeling, the CASE model is not yet the government’s model. Nevertheless, it was viewed as quite good (90 percent accurate in forecasting tax revenues) and is used as the standard against which the MOE’s internal forecasting results are judged. When asked why the model was not the government’s model, the reply was that the counterpart had received conflicting assistance in forecasting and he was not prepared to choose one approach over another. Thus, his staff was still using the old methods of forecasting. It was also pointed out that while his staff could now refine the data and run the model as a result of CASE’s work, they could not modify it as the structure of the economy changed. Furthermore, they could not interpret the findings and still had to rely on CASE.

The further need to train the MOE staff to modify the model and interpret the results would suggest a continuation of the CASE activity. However, we were told that the government now expects to take up a Canadian offer to develop a new and more sophisticated model. The need for further CASE activity was seen only to bridge the period between now and the time the Canadian model was operational, estimated at 2 years by the MOE and 1 year by the U.S. Treasury adviser.

On the public policy side, the response to the material that HIID mails out quarterly indicates a positive attitude for this function among the Ukrainian reform community. HIID’s mailing list is large and growing. While reform has been under way for almost 10 years, the business and non-government reform community still has little access to government data and good analyses. HIID’s program is one of the few, reliable providers of this kind of material. This is a very valuable function.

Similarly, regular HIID seminars and guest speaker lectures are well attended, indicating a real demand for this service. Not only are these events educational, but also they build the momentum for reform among opinion makers and policymakers.

Coordination

Under the new expanded concept of macroeconomic advice, an abundance of advice is offered to Ukraine from a host of donors and institutions. USAID’s funding of HIID, CASE, and Barents under SO 1.2 and its funding of related programs in privatization, pension reform, and the development of local governments could be construed to overlap with the IMF’s activities. Similarly, with the U.S. Treasury macroeconomic adviser in the MOE.² There are no problems if the IMF, the World Bank, and U.S. experts agree on the findings and recommendations for a particular prerequisite action, but agreement is not always the case.

There are several examples of conflict related to the work HIID is doing. For instance, HIID has been heavily engaged in an analysis of the shadow economy and is recommending, among other things, a reduction in taxes to encourage these enterprises back into the formal economy. Given its inability to get the GOU to cut expenditures more deeply, the IMF does not agree with HIID’s recommendation. This leaves the GOU with two alternative policy recommendations. With no internal capability to evaluate which option would be best for Ukraine, the government could make

² Overlap also occurs with the World Bank, although the World Bank has its lending program temporarily on hold and it is quite experienced with working on problems in which other donor advisers are involved.

its choice only on the basis of which institution is more powerful. This is not a sound basis for a government decision.

A second example is pension reform. HIID has conducted an in-depth analysis and provided recommendations on the timing for introducing private pension plans. The World Bank recommends a different schedule. Policy differences also exist between HIID and another USAID contractor (PADCO) on this topic. Again, the government is at a loss to choose between options on their merits because it does not have the internal capacity to evaluate each organization's proposal.

These examples of overlap and conflicting advice should not be construed as a criticism of either side's advice. They are meant to illustrate the complexity of advising reformers in this transitional environment. What the Ukrainians may not yet appreciate is that macroeconomics often produces more than one defensible route to a desired policy objective.

USAID has done an outstanding job of minimizing these conflicts through the division of labor represented by their contractors and grantees. USAID was also complimented by the IFIs and other donors for its specific efforts to regularly hold donor coordination meetings. The fact that the two examples of differing recommendations were cited is not significant to the overall complementarity of USAID's program internally and with the IFIs and other donors.

Local Capacity Building

All USAID-funded technical assistance activities under SO 1.2 are charged to a greater or lesser degree to help build local capacity. HIID has been quite active in this area with special emphasis on improving the level and competence of public discussion and training of the new generation of economists and policymakers. HIID's intern program provides a valuable experience for the graduate students at Kyiv Mohyla Academy by involving them in HIID's work on the real economic problems of the Ukraine. This is a unique program to expose these students to applied economics. More important, in so far as these students pursue a career in Ukraine, they will have solid knowledge of and experience with the specific issues that will continue to be important for policy analysts and policymakers well into the future. HIID has also conducted staff training within the MOE and the central bank and it was well received.

CASE has been successful in building the capability of the MOE to understand and refine its data and run the CASE model. It has also been successful in getting the senior officials in the ministry to understand that results of various forecasts should be questioned and analyzed until they are understood and intellectually defensible. In the past, there was little internal questioning of the figures generated by the ministry's forecasting methodology. The CASE model itself is not institutionalized and it is unlikely that it will be.

Similarly, while the participants in the RAND/ICPS seminars have blended back into the system, a substantial number of interviewees complimented this assistance in both form and content. This kind of training is analogous to USAID's mid- and senior-management seminars with a stronger orientation to actual issues. There is clearly more room for this kind of training in the GOU.

Institutional Reforms

HIID has been a player in recommending government reorganization and believes it was influential. The major player in this area is the World Bank. There is no meaningful way to assess HIID's impact

on institutional reform. The World Bank stated that the proposed organizational structure of its program to support for the MOE and the MOF was developed by the British Know-How Fund.

The Deputy Minister of Economy in charge of macroeconomic analysis and forecasting informed us that his efforts to improve the organization of his departments have benefited from the advice and council of the U.S. Treasury macroeconomic adviser. The evaluation team believes this to be a creditable assessment.

U.S. ASSISTANCE IN TAX POLICY AND ADMINISTRATION

In any country making the transition from a command to a substantially market-driven economy, a dramatic change in the fiscal system is inescapable. Changes are required on the tax and the expenditure sides of government budgets. On the expenditure side, responsibility for providing social services such as education, health, and welfare is shifted from enterprises to government. In addition, as inefficient state enterprises close down or curtail production, the absolute magnitude of demand for public services increases. Moreover, this increased demand for public expenditures occurs just as enterprise incomes, and hence the tax base, are scaled down.

On the revenue side, the transition to a market economy eliminates the ability of the government to make arbitrary demands on enterprises or individuals for revenue. Taxation becomes a matter of law. Hence government must be able to prove that tax is owed, and it must be able to collect against the statutory liability of taxable entities.

The transition to a market economy in Eastern Europe and the states of the former Soviet Union has been occurring simultaneously with political democratization. Just as decisions in the economic realm are significantly decentralized, political power and decisions tend to be decentralized. Sub-national governmental jurisdictions assume a significantly more important role. Services that are mainly consumed within a local community are appropriately chosen by that community as is the way the community elects to pay for them. However, under the command economy, such governments were typically powerless to tax themselves or to choose and provide the public services they wanted. Thus an entire new complex of relationships between national and sub-national governments, and their taxing and expenditure responsibilities, arises as part of the transition process.

One element of the national/sub-national relationship is that national values usually hold that there is some minimal level of key public services, such as primary health care, to which all parts of the nation are entitled, regardless of their ability to provide it for themselves. Means chosen by governments for providing for this universal coverage are referred to as equalization policies. In order to have equalization, means must be devised to collect resources nationally and use them to provide the minimal service level to communities that cannot afford to provide them for themselves. This subject matter falls under the heading of "intergovernmental transfers." This entire complex of relationships between national and sub-national jurisdictions is usually referred to as intergovernmental fiscal relations (IGR).

As the foregoing discussion suggests, the institutions of government required to support a market economy, with a democratic political foundation, are quite different from those of a command economy. Moreover a change in the core institutions of a society require a supporting statutory foundation. Thus the transition that Ukraine is undergoing requires fundamental changes in the legal and institutional environment within which the economic system functions. This legal and

institutional environment is required to enact and implement the policies of a market-directed economy.

The USAID Mission to Ukraine has targeted a significant bundle of resources in recent years on helping the Government of Ukraine to amend the legal, institutional and policy environment that underpins the fiscal system discussed above. The broad objective is not fiscal modernization for its own sake, but fiscal modernization as a necessary precondition for strong macroeconomic performance. It is generally acknowledged that the fiscal sector and the macroeconomy both influence and are influenced by one another. Therefore, it is eminently logical to consider the efficacy of technical assistance in macroeconomic policy analysis and fiscal analysis, simultaneously.

Tax Policy

Rhetoric to the contrary notwithstanding, taxation represents a disincentive to production. Thus a primary objective of tax policy in countries that seek maximum material well-being for their populations is to minimize the disincentive effect. This is a complicated matter, and has been the subject of mountains of economic research. As a result of this research, which combines theory and empirical evidence from a wide variety of nations and sub-national jurisdictions, there is a reasonably well-defined body of analytical architecture that can be applied to evaluate the implications of particular taxes and of combinations of taxes for production. However, most of the expertise required for this kind of analysis resides in countries that have long employed market-directed economic systems. This is an important area therefore in which foreign technical assistance can be helpful.

In addition to influencing the aggregate level and rate of growth of production, the particular taxes and tax rates selected can have significant influence on the mix of goods and services produced, the location of economic activity, the technologies employed, and the way that production (and hence income) is distributed. This set of issues is also complicated, but decades of research and experience have yielded a significant body of knowledge. In the hands of well-trained experts in the field, costly mistakes associated with bad policy can be avoided. But again, the professional expertise required to wield the appropriate analytical tools is scarce, even in the most advanced market economies. Failure to bring this expertise to bear on the formation of tax policy is likely to produce costly and unnecessary errors. Thus it is again an area of technical assistance that can yield high returns. Indeed failing to take advantage of such expertise is almost certain to involve high costs.

The foregoing discussion presents ways in which tax policy affects production and distribution of income directly. Taxation produces the revenue that plays a major role in determining how much governmental activity will influence the level and growth of aggregate demand—the greater the shortfall of revenue over expenditure, the greater the expansion of aggregate demand (and/or of the government's share in total spending). This in turn can have a significant influence on such dimensions of macroeconomic stability as price level, exchange rates, interest rates, and the cost of capital. Price inflation also constitutes a tax, and one that usually falls especially heavily on the poorest and most defenseless members of society. Since all of these factors may be significant influences on productive investment, tax policy has this more indirect potential to influence the level and distribution of economic activity and income.

All of the foregoing can be expressed much more economically, as follows: "Tax policy can have an important influence on the level, the rate of growth, and the structure of production, income, and employment. It is a primal element of the transition from a command to a market economy."

The most brilliantly conceived, designed, and articulated tax policy package is of no value whatsoever if it is not translated into an understandable and implementable body of law. Thus tax policy requires the close collaboration and interaction of economists who can evaluate its sectoral, aggregative, and distributional consequences and lawyers who can codify it appropriately. To descend from the blue sky of theoretical speculation, we turn in this section to the specific content of U.S. technical assistance in tax policy and administration.

The package of USAID-funded technical assistance in the area of taxation clearly recognizes, at least qualitatively, that tax policy is an important component of the transition process. The U.S. Treasury provided intermittent advisers in tax policy, specifically tax codification, from 1994 to mid-1997. Since then, Treasury has had a resident adviser, a lawyer, working on aspects of the tax code. USAID technical assistance provided under contract with Barents also includes resources for assistance in tax policy. The U.S. Treasury adviser in the area of tax policy appears to be well qualified to advise on tax legislation. In the present circumstance, he must rely on economists provided through the Barents contract for analysis of the economic implications of various taxes. Quantitatively, however, tax policy formulation is clearly a minor emphasis of the technical assistance. Moreover, the Ministry of Finance has not so far acted forcefully to win a comprehensive improvement of tax policy.

This does not mean that there has been a shortage of advice on tax policy. Parts of the tax structure are in place as a result of U.S. assistance and IMF pressure. However, essential elements are lacking or languishing in the Verkhovna Rada. The IMF and the World Bank include significant tax policy reforms as conditions of their programs of assistance. Various NGOs have also addressed the issue of tax policy changes in their research agendas and in their interaction with various elements of Ukrainian society. What appears to be missing, however, is a capacity on the part of the government to formulate its own version of a comprehensive tax policy program and then to use all the tools of political and intellectual persuasion to push it through the parliament.

Normally, one would expect to find that capacity in a unit in the Ministry of Finance. However the Ministry's analytical unit lacks staff, is relatively new, and does not have the expertise to craft such a program. It does not appear to be the case that the U.S. technical assistance in tax policy has contributed significantly to the Ukrainian transition to a market economy.

Summary and Concluding Observations on U.S. Assistance on Tax Policy

While the Ukrainian economy has not yet been able to record a full year of vigorous economic expansion, it would be a mistake to conclude that technical assistance in tax policy has had no worthwhile results. The adoption of the destination-based value added tax (VAT) is a noteworthy accomplishment. This was the result of efforts by a variety of donors, including USAID-funded advisers contracted by the U.S. Treasury Department. The same is true of the enterprise profits tax (EPT). Significant flaws remain in both of those taxes in terms of policy and administration. Nevertheless, it will be much less difficult to correct existing taxes than to have to start from the beginning.

Technical assistance from the U.S. Treasury’s adviser on tax policy has resulted in the drafting of a property tax law. Although it has not yet been enacted, it has an audience and cannot be discounted as of no value. Economists and lawyers from the Barents group have been asked for advice on the codification of tax laws in many areas, and it seems very clear that their advice is often valued, at least by the immediate client. In one case, it is likely that the reaction of a Barents adviser to an ill-conceived proposal for a turnover tax prevented that tax from being enacted as a replacement for the destination-based VAT. That kind of contribution is exceptionally valuable.

What appears to be the real bottleneck to tax policy reform is that it has not had a champion within the government with sufficient political influence, stature, and persuasiveness to move it to the top of the agenda of the government and the parliament. Until this happens, it is the judgment of this team that meaningful tax reform will not occur.

TAX ADMINISTRATION

“Tax administration *is* tax policy.” This is a retort often offered by experienced tax reform specialists to the claim that tax policy is more important than tax administration. What this means is that in deciding how to allocate administrative resources across taxes and functions, tax administrators can cause an outcome that conflicts with what policymakers had in mind. This is particularly true in countries in which such decisions are at the discretion of tax officials, and in which the tax base is quite narrow. For example, by holding back resources from the essential function of getting all the taxpayers onto the tax rolls, the rate on those who are on the rolls is higher than it would otherwise be.

Similarly, nonstandard accounting practices can have the effect of imposing different tax rates on two industries or two firms with the same economic income. This distorts incentives, resulting in resources being allocated or re-allocated purely to gain a tax advantage, even though such a policy decision may never consciously have been made. Worse yet, if tax administrators are allowed discretion in establishing tax liability or in directing collection activity, this can create an incentive to use the discretion for corrupt purposes.

Basically, what is generally regarded as “good” tax administration is administration that taxes individuals and activities fairly and evenly, and that generates something very close to the amount that is due under the law.

While recognizing that tax administration might be tax policy, it is important to recognize that a “bad” tax that is well administered can do more damage to an economy than one that is poorly administered. Such might be the case, for example, with a tax that rewards consumption and punishes production. (Taxes on foreign trade often have this effect.) If a government learns how to enforce such a tax more effectively, it is likely to increase disincentives to investment, production, and employment.

For all the foregoing reasons and others, USAID has placed a strong emphasis on technical assistance in the area of tax administration. Technical assistance has also come from the IMF, the World Bank, and from U.S. Treasury advisers. As is seen in Exhibit 1, we judge this component to have been quite effective. This judgment holds whether judged by the benchmarks set out in the original Barents task order, by the various records and reports documenting activity and outputs, or

by the testimony of counterparts. The Barents technical assistance (TA) team has placed particular emphasis on the following areas:

- Promotion of voluntary compliance, through both carrot and stick—that is, by training and technical help in modern audit techniques and audit selection criteria, and by preparation and dissemination of taxpayer education materials.
- Computerized tax information systems. This has been mainly in the area of software and programming. Part of a large World Bank loan, if approved, is expected to provide the lion's share of future funding for this activity. But U.S.-funded technical assistance has been helpful to the STA in the interim.
- Training and materials in international accounting standards (IAS). Progress in this area has not been as great as had been hoped and expected. Nevertheless, while the use of IAS is still far from the rule of the day, significant progress has been made in elevating the general quality of accounting for tax liability computation.
- The Barents contract originally anticipated that policy governing all five of the major sections of the planned code (VAT, EPT, PIT, and excise and administration) would have been strengthened by the passage of the new tax code. Accordingly, the Barents team was set up to address the implementation of the new taxes once the code was enacted. Information technology specialists were included. The combination of the delay in the World Bank loan and the failure of the Verkhovna Rada to pass the new code have required that these resources be directed to other administration tasks. This is not the ideal way to decide where to direct TA resources, but it had to fit the divergence of reality from expected conditions. The question the situation raises is whether, given what now seems to be that reality, it still makes sense to keep these resources around after the current project expires.
- Computerization of tax information and assistance in audit and in accounting help with enforcement of the tax laws. As noted earlier, this is an important part of encouraging voluntary compliance. U.S. funding is also supporting direct assistance in collections by having a U.S. Treasury adviser assigned to the STA. This adviser reports separately from the Barents advisers, and unlike them, reports directly to the Deputy Head of the STA. His clients include the Tax Militia. This individual is thoroughly familiar with training materials on the importance of establishing the taxing authorities as objective, fair, and honest. Unless U.S. Government representatives in Kiev are convinced that the tax authorities are thoroughly professional and objective, they might want to consider focusing this individual's efforts in his aforementioned areas of expertise.

Summary and Concluding Observations on Tax Administration

In many respects the tax administration component of U.S. technical assistance has been unusually successful (see Exhibit 3). The Barents team's work plan has been agreed on and signed by the resident Chief of Party and the Deputy Head of the State Tax Service. The counterparts seem actively interested in the assistance, and there is evidence that much of the advice has been worked out in conjunction with the GOU counterparts. The STA has created a Department of Modernization to

Exhibit III. Summary Evaluation: Scoring of Individual Activities with Reasons for Ranking Tax Policy and Administration

Activity	Results	Potential	Importance for Capacity	Importance to Reform	Average
Tax implementation and collection	4—Significant results in tax Administration, but less in actual collections.	4—Potential contribution of tax admin. is great. Good counterpart relations.	4—Success in this area will reflect permanent capacity expansion.	3—Administration reform may be too far ahead of policy reform.	3.75—USAID in a key role.
Enforcement	2—USAID's Barents team not in a central role here. However, audit improved with Barents TA.	3—Enforcement is important, and a U.S. Treasury Advisor is well placed in STA. Barents TA in audit, acc'tg, and IT support.	4—Enforcement very important, particularly after tax structure rationalized. But risky if abused.	3—Importance to reform will rise in future, when tax structure in place and safeguards against abuse.	3.00
Tax modeling and revenue forecasting	2—Not a Barents priority.	?			Notional: 2.75
Computerization	4—Progress is good, but hold-up of IBRD disbursement limits effectiveness.	4—Potential is great, but software should not get too far ahead of (a) hardware, and (b) policy reform.	3—Importance for capacity is great, but it isn't obvious that TA is needed to build it.	2—Not so much an issue of reform as of resources.	3.25

implement comprehensive tax administration reform, and the head of the department holds weekly meetings with the TA advisers (excluding the U.S. Treasury adviser on collections, who reports through a separate channel). The advisers from Barents appear to have an unusually good working relationship with other advisers, including those from the U.S. Treasury, and the IMF.

Yet, despite these observations, it must be noted that tax administration does appear to be out in front of tax policy and, to some extent, of tax legislation. Moreover, we have not seen evidence of a close working relationship between experts in tax administration and the economists in the Ministry of Finance who work on tax policy. This gives several reasons for concern.

First, the data required to effectively monitor a reformed tax code (or reformed but coordinated set of tax laws) must be generated from the information technology (IT) system that is put in place. That system, therefore, should be dictated in large part by the particular policy shape of the taxes that are adopted. Next, the IT system must be able to generate the data required for continuously updating the revenue forecasting models that are essential for budget planning and collections monitoring. Finally, the skills needed by tax administrators and the functions they must perform, not to mention the number required and the way they are organized, depend most critically on the structure (i.e., policy) they are to monitor. For example, a PIT that has only one rate and that has no exemptions or deductions does not require a large, highly sophisticated corps of people, or the supporting IT, to look for people claiming inappropriate deductions. This is an extreme example, but we hope it makes the point that the issue of complementary policy and administration is far from a trivial one. We will revisit this point in Chapter 3, Recommendations.

BUDGET REFORM

Under this activity, the evaluation Terms of Reference (TOR) summarizes the technical assistance objective as “Introduction of systems of budget preparation, program evaluation, and budget execution to produce budgets that are realistic and transparent, conform to international standards, and enable the government to achieve and maintain economic stability.”

Achievements

The activities are helping to achieve the desired result (see Exhibit 4). Assistance for systems development provided by USAID has produced the deliverables essential for a budgetary system to be able to incorporate and execute appropriate macroeconomic policy. During the next two to four years, donor assistance should focus on perfecting use of the existing deliverables, and the associated system, rather than on producing new systems. The U. S. Department of Treasury adviser should be the primary provider of such assistance with USAID systems development assistance serving in a subordinate and supporting role.

The short-term technical assistance goal should be a system capable of implementing macroeconomic policy, not one that conforms to the most modern international standards. To be able to implement macroeconomic policy, the budgetary system should be able to produce and incorporate realistic budgetary estimates, eliminate public expenditures inconsistent with a market economy, and reduce overall expenditures to levels consistent with the policy in a way that reduces social pain to a politically acceptable level. The existing system can now meet this standard. (The budget systems of industrialized countries had these characteristics long before they instituted

Exhibit IV. Summary Evaluation: Scoring of Individual Activities with Reasons for Ranking Non-Tax Fiscal Reform

Activity	Results	Potential	Importance for Capacity	Importance to Reform	Average
Budget process	4—Basic system to support reform in place and producing results.	3—Technical progress possible but top management support of operational progress unclear.	4—If operational capability for current system developed, macroeconomic policy can be implemented.	4—The vehicle for implementing macroeconomic policy.	3.75—But USAID in secondary role.
Treasury management	4—Basic system to support reform in place and producing results.	4—Treasury wants to improve. No technical obstacles to doing so. Operationally, Rada seems to want to control the executive.	4—If technical improvements implemented and operational capability developed, policy can be implemented.	4—Policy cannot be implemented without effective budget execution.	4—But USAID in secondary role.
Fiscal analysis for the Rada	3—Influences Rada.	1—Political obstacles to progress great.	1—Won't develop much internal capacity.	2—Can contribute to preventing bad legislation.	1.75
Intergovernmental finance	1—No tangible results to date.	2—Can focus on the Executive for progress.	3—Can be important if it develops MOF capacity.	3—Impact important but below basic macroeconomic policy.	2.25
Public administration reform	2 - No operating impact from reform yet.	3—Technical progress possible but top management support of operational progress unclear.	5—All reform depends upon good top level decision-making.	5—Reform cannot occur without top level approval of the policy.	3.75—But USAID in secondary role

program budgeting. Line item, economic classification, budgeting, based on the expenditures of the prior year, is acceptable.) In interviews, executive branch government officials confirmed this finding, saying that they believe the system can prepare a budget incorporating the government's macroeconomic policy.

Assistance has produced a budget calendar, new classifications, new procedures and computer software, and new formats. These items were implemented in calendar year 1997. Training in a manner of thinking consistent with budgetary analysis has been given to top budgetary officials. The Presidential decree mechanism has been used to set budget ceilings and spending priorities.

Revenue estimating models are now producing realistic revenue estimates for tax revenues. Since 1997, budget requests are produced based on actual expenditures of the prior year rather than the standards and norms of the previous system. For FY 2000, the government produced a budget with a surplus assuming passage of revenue-producing legislation. Thus, the mechanism has advanced to the point where it can incorporate appropriate macroeconomic policy. For the first phase, then, U.S. technical assistance has been a success.

For purposes of macroeconomic policy reform, the need is not for additional technical assistance deliverables. The need is for government budget preparation personnel to become proficient in the budgetary system that they now have. (Technical assistance work is under way to develop a computerized budgetary information system throughout the MOF. This system would support the existing budgetary system and should continue to completion.)

Personnel in the main budget department are not yet satisfactory budget analysts. No matter. Reform cannot wait. If the opportunity presents itself, the existing level of expertise must be used to accomplish as much reform as possible. This should be perceived as the task, and the fact that the budgetary system is not at the best international standard should not be allowed to detract from whatever level of progress can be made.

Coordination

Coordination among the donors has been satisfactory. Because technical assistance would be entering a new phase, some re-orientation in coordination might be helpful. In the overall scheme of donor assistance, the IMF is to set the macroeconomic reform agenda. It has been doing so and should continue to do so in the new phase. For execution of the agenda, it will be assisted by (dependent upon) the function now performed by the U. S. Department of Treasury adviser. Consequently, IMF officials should initiate closer coordination with him to ensure that he understands thoroughly their position and can, therefore, be of greater help to MOF as it decides how it wants to proceed.

In the overall scheme, USAID is to provide the system development and capacity building assistance needed to execute the IMF agenda. This aid has been provided. The budgetary system is now minimally satisfactory. USAID technical assistance should now assume a secondary and supporting role. The U. S. Treasury adviser (or an alternate if the U.S. Treasury does not choose to continue this technical assistance activity in Ukraine) should provide technical assistance leadership on budgetary matters over the next two to four years. Additional USAID technical assistance should be responsive to and support this adviser.

The resident U. S. Treasury adviser needs help from higher level U. S. Department of Treasury officials. For him to play his assigned role, he needs to be perceived as a senior operational adviser.

His office and access to government officials are not consistent with the role assigned to him. To be effective in his role, senior U. S. Department of Treasury officials should intercede in his behalf.

Local Capacity

Local capacity to operate the new system has been developed, but it is rudimentary. It should be perfected over the next two to four years by operating and using the improvements that have been made. The key requirements to do this are operational coaching of top MOF budget managers by the U. S. Department of Treasury adviser, training of the sector departments in their tasks under the new system, and introduction of budget analysis and the challenging function. Production of new outputs should be directed at supporting this perfection process.

Institutional Reforms

The new system has been in operation since calendar year 1997. It is not institutionalized and could be lost if not reinforced. The new system includes the basic requirements of any modern budgetary system and must be used by MOF budgetary personnel until its characteristics are internalized. At the same time, plans to proceed to higher levels of budgetary performance, for example, program budgeting, should be delayed.

TREASURY MANAGEMENT

There is no separate summarization of the technical assistance objective for this activity included in the evaluation TOR. The objective here is the same as that for budget process, but the focus is on the execution portion of the budget process. (debt management is not within the scope of this evaluation.)

Achievements

The activities are helping to achieve the desired results. But USAID-provided technical assistance has played a relatively minor role. The IMF and World Bank are the primary providers of assistance. A data processing system is being developed that USAID has supported during a hiatus in World Bank support. This system should be completed. A new World Bank loan can be used to fund all required assistance, but the government does not want to use loan funds for technical assistance. USAID could consider continuing system development technical assistance to ensure that the system is completed. If a USAID budget reduction is necessary, this activity is a candidate for reduction, because of the presence of the World Bank loan.

Implementation of appropriate macroeconomic policy requires a budget execution system that controls actual expenditures so that money is spent only on items approved by parliament and in amounts that do not exceed the legal appropriation. The existing treasury system can accomplish this. Currently, however, the actual operating problem is that cash collections are habitually below revenue estimates in the budget, and the budget execution system must be able to reduce expenditures and allocate reductions among the spending agencies so that actual expenditures are kept within actual collections. The existing system is capable technically of doing this. (The

complaint, particularly by the Verkhovna Rada, is about the manner in which government decision-makers allocate the expenditure reductions, but this is not a technical issue.) In interviews, executive branch government officials confirmed this finding, saying that they believe the system can adequately execute a budget incorporating the government's macroeconomic policy.

The Treasury is progressing toward a single treasury account to be used for all levels of government and incorporating a general ledger and accrual accounting. The Treasury also is to bank all cash collections and make all payments for the government. In support, overall technical assistance has helped to institute a new chart of accounts, reduce the number of spending agencies, incorporate off-budget spending into the budget, and improve the timeliness and accuracy of periodic reporting of cash collection and expenditures. The World Bank and the IMF are supporting this effort.

When World Bank assistance stalled, USAID technical assistance moved in to support an interim system and keep the process of Treasury improvement moving ahead. USAID-provided assistance helped prepare the information technology strategy, select appropriate software to support the strategy, and prepare a training needs assessment and associated career training strategy. The assistance also helped with Y2K compliance, modifying the accounting system to accommodate extra-budgetary accounts, and improving transaction recording and reporting. The IMF and the Ukrainian Department of Treasury officials report that this assistance was very valuable.

The Treasury system is scheduled for completion in three years. In this process, the Treasury would benefit from assistance from consultants familiar with the budget structure and system, that is, Barents, so that the interface between the budget and the accounting system can be improved and an integrated single treasury database can be developed.

Coordination

The Treasury has a resident IMF adviser, and, apparently under his leadership, coordination among technical assistance providers to the Treasury appears quite good. In the next phase, as assistance to the budget process becomes more operational, the IMF adviser should ensure that the U.S. Treasury adviser is thoroughly informed about the relationship between assistance to the Ukrainian Treasury and the budgetary system. Moreover, the next phase of technical assistance will make the IMF advisor's job more difficult. On one hand, the interim treasury system is adequate to implement the budget as planned, and the system should be operated to do so. The IMF adviser should play the same role for treasury management as the U.S. Treasury adviser plays for the budget process. In doing so, treasury officials should not be distracted by system reform. Yet, the World Bank is providing a major loan to finance system improvement and undoubtedly will pressure Treasury to make progress on implementing the new system. The IMF adviser will have to play an important role assisting Treasury officials with balancing operating requirements against system improvement requirements.

Local Capacity Building

USAID has been a relatively minor participant in building Treasury capacity. Nevertheless, a very sophisticated system, perhaps more sophisticated than necessary, is being developed. Treasury personnel can operate the system that now exists and is needed for macroeconomic reform. They will

not be able to operate the new system without substantial training. A training needs assessment for the central Treasury has been performed. (The evaluation team is uncertain whether the assessment covers local government needs.) Training has not been provided yet. The training requirement will extend to all local governments. This is a huge requirement and is a technical assistance challenge. Beyond this, the major operational problem currently is in the way allocation of expenditure reductions is made. This problem should be brought under control, if it exists, as more realistic revenue estimates are included in the budget and the Verkhovna Rada strengthens its control over budgetary execution. As the Verkhovna Rada strengthens its control, a small technical assistance project to develop and implement a formal and transparent procedure for budgetary reallocations based on revisions to long-term revenue estimates might be in order.

Institutional Reforms

The new Treasury is still undeveloped, but is in the process of change. Major reforms are still coming, and the improvements that have been made, without substantial training and operational experience, could not have been institutionalized. All reforms to date will be lost if there is a gap in technical assistance.

FISCAL ANALYSIS FOR THE PARLIAMENT

Under this activity, the evaluation TOR summarizes the technical assistance objective as follows: “Fiscal Analysis Office provides objective analyses of budget execution and of proposed budgets and tax law changes, and advises the budget and tax committee and the parliament generally on their potential impact on government activities and economic growth; the goal is to have it designated officially as an arm of the parliament, similar to U. S. Congressional Budget/Joint Tax Committee.”

Achievements

(Achievements addressed here relate primarily to budget adoption and execution. Achievements related to intergovernmental tax policy are addressed in the evaluation of intergovernmental finance.) The activities may be helping to achieve macroeconomic policy reform and democracy, but there is reason to believe that the Fiscal Analysis Office (FAO) will not be designated an official arm of the parliament within the foreseeable future. Funding for the FAO may be marginally beneficial; but, if severe funding reductions are needed, this is a candidate.

Macroeconomic policy reform does not require parliament to be able to develop its own policy alternatives and select from among them. It does require, as does democracy, that the parliament understand the policy presented by the government, approve that policy if it agrees, and then hold the government accountable for execution of that policy. The FAO is assisting the parliament with accomplishing these things in the short-term.

The FAO is a USAID-funded staff operating externally to the parliament, led by a senior Ukrainian professional with guidance from an expatriate consultant. Over the two years of its existence, it has produced eight editions of the *Quarterly Budget and Fiscal Review*, a version of the *Budget Chartbook* for FY 2000, and analyses of the executive budget. It has assembled a

comprehensive database for tracking execution of state and local budgets. It has conducted a study tour to the United States for some members of parliament.

Examination of the *Review* and *Chartbook* suggest that the work of the FAO is not of sufficient depth to assist in policy formulation (policy formulation is not a minimum performance requirement for the parliament at this time). The work of the FAO essentially reports on the status of budget execution and describes the content of the executive budget so that parliament may better understand what revenues will be raised and how the revenues will be spent. The FAO seems to gather data and present and describe the data for better understanding. This is supportive of macroeconomic reform; for, if used by the parliament, these documents can help its members understand the executive budget so that approval can be given or changes can be requested and so that control—matching the approved budget to actual results—can be exercised. Members of the Verkhovna Rada Budget and Banking and Finance Committees confirm that the FAO is helpful to them. One can conclude, therefore, that the FAO is playing a useful role in the policy reform process.

A distinction should be made between the formulation of and the evaluation or critique of policy. FAO does not appear to be well positioned to perform the former, but it can and has performed the latter. Given this capability, the FAO can potentially contribute to preventing the parliament from passing bad legislation. By a process of elimination, good legislation may then pass. However, the more bad legislation generated by Verkhovna Rada members that the FAO contributes to defeating, the more enemies it will make, and the less chance it will have of ever becoming an adjunct to the Verkhovna Rada staff.

Leaders of the two committees have stated unequivocally that FAO will not become Verkhovna Rada staff for at least two years. Personnel reductions in the executive branch are to be replicated in the Verkhovna Rada, and the Verkhovna Rada will not agree to fund the FAO while it is reducing its current staff. Moreover, one committee chairman expressed concern that, if the FAO were to become Verkhovna Rada staff, Verkhovna Rada leadership would attempt to politicize it.

A theoretical argument can be made that the FAO can become a nonpartisan staff of the Verkhovna Rada only in the long-term. The probability is that the Verkhovna Rada will prefer to spend its money on partisan staff. The longer it functions as an adjunct to the staff of the budget and finance committees, the less likely it will ever be absorbed by the Verkhovna Rada. Its assistance will make these committees stronger relative to the authorization, substantive, or sectoral committees, and these committee will likely retaliate by refusing to give the votes necessary for absorption (or by first absorbing the FAO and then killing it). At least one interviewee opined that an external organization, even when staffed by Ukrainians, as FAO is, will never have direct impact on policy. This appears to be a reasonable expectation. Although the FAO may make a contribution to macroeconomic policy reform and to building democracy, its contribution is probably marginal and its long-term prospects are not good.

Coordination

In general, coordination is not an issue—neither the IMF, the World Bank, nor the U. S. Treasury works with the Verkhovna Rada and the FAO. One item is of concern: the FAO is building a separate database on budget execution. It does not seem wise to have two such data sources. Differences are almost certain, which probably means endless discussions of the differences. It would appear

preferable to have one official database maintained by MOF/Treasury that could be accessed by the Verkhovna Rada and that would respond to design changes from the Verkhovna Rada.

Local Capacity Building

Except for one expatriate adviser, the FAO is composed of Ukrainians. Nevertheless, if the goal is to make the FAO an arm of the Verkhovna Rada, capacity building may be at ground zero. Members of the FAO are paid more than Verkhovna Rada staff, and there is no certainty that the current FAO members would accept a pay reduction to work for the Verkhovna Rada. At the same time, there has been no formal effort to transfer skills of the FAO members to Verkhovna Rada staff. Thus, there may only have been capacity building if the FAO can be transferred to a Ukrainian NGO or transformed into an NGO.

Institutional Reforms

The evaluation team identified no institutional reforms within the Verkhovna Rada vis-à-vis the FAO that could be considered lasting. At present, there is little direct possibility of initiating FAO-related reform within the Verkhovna Rada. The FAO gives the impression of having internalized its operations and may be considered to have reached institutionalization. If it were to be absorbed by or transformed to a Ukrainian NGO, a useful institutional reform would have been accomplished.

INTERGOVERNMENTAL FINANCE

Under this activity, the evaluation TOR summarizes the technical assistance objective as “Improvement of the system of local government finance; introduction of formula-based transfers from the national budget to sub-national and local governments.”

Achievements

To date, there is no tangible benefit from this activity in terms of the TOR statement of the technical assistance objective. The probability is that there will be no direct benefits so long as the effort is treated as a purely technical undertaking. The activity is now centered on the Verkhovna Rada. USAID could consider re-directing it to the MOF and to local government to tie it more closely to political decision-making.

The evaluation team asked for the four most important deliverables for each activity. For this area, the two most significant are of marginal utility. The first consists of a passage in the FY 1999 budget that provides for automatic delivery (the apparent improvement) of transfers determined in the traditional manner. The second relates to participation by the intergovernmental finance adviser on a working group appointed by the Cabinet of Ministers that is to ensure that a formula driven transfer system will be included in the future 2001 budget. This effort is apparently related to the World Bank Municipal Development Project. To date, there has been no tangible accomplishment. The probability is small that there will be direct impact on government policy from a staff external to the government. The working group may help; but the potential for impact appears not to be large.

Intergovernmental finance deals with the assignment of revenue and expenditure responsibilities among the levels of government and to the method of allocating transfers from the center to local government. These items are important for macroeconomic policy and for economic development. They are also important for political stability and for getting elected. Therefore, there are two perspectives on how the assignments and transfers should be made —the economic and the political. Politicians almost always hold the political viewpoint, although it may be tempered by the economic; and they almost always control the decision. Placing an economist on the outside to give economic advice is likely to have little affect.

If a politician, that is, a Verkhovna Rada member, is to incorporate economics into his thinking, he probably wants the economic advice coming from a professional staff member who shares his policy, political, and partisan predilections. He is more likely to take it from partisan staff trained in economics.

If economic advice on intergovernmental finance is to be effective, it should be married to politics. Therefore, USAID could consider re-directing its intergovernmental finance assistance from the Verkhovna Rada to the executive branch. If this is done, advice to the executive will have the political weight of the IMF, and policy proposals to the Verkhovna Rada will have the political weight of the executive.

He who imposes taxes and receives the blame for doing so wants to receive the benefits that accrue from spending the money. Usually, only secure politicians think differently. In Ukraine, the majority of revenues are raised by the center. The center must be persuaded to give up some of its revenue and expenditure responsibilities. If the GOU actually develops and legislates a formula based system in the 2001 budget, USAID could consider mounting an intergovernmental finance technical effort to train local government officials in any new responsibilities arising from the formula based system. However, while the GOU may approve something in the 2001 budget to satisfy World Bank conditionality, the team is not sanguine that it will be a meaningful or lasting reform. We note, for instance, that while the IMF conditionality specifies the PIT for local government and the EPT and excise tax for the central government, an early act of the new prime minister canceled this earmarking in order to ensure adequate revenues were available for the central government. Actual revenues for the central government have and will likely continue to lag forecast revenues (about 80 percent), making it difficult for the central government to agree to a formula based system.

Coordination

The World Bank appears to be working in this area. Neither the IMF nor the U.S. Department of Treasury seems very active. The World Bank representatives and the USAID intergovernmental finance adviser appear to be coordinating satisfactorily.

Local Capacity Building

Primary capacity currently lies with the expatriate adviser who works with the FAO. No attempt has been made to develop skills within the government. Therefore, no reliable local capacity has been developed unless the FAO becomes incorporated into the Verkhovna Rada or becomes an NGO committed to continuing its current function.

Institutional Reform

No attempt has been made yet to institutionalize an intergovernmental capacity within the government, so there has been no institutional reform. However, USAID has made a number of overtures toward working directly with the MOF and this may provide an opportunity to build capacity in the MOF's local budgets department.

PUBLIC ADMINISTRATION REFORM

Under this activity, the evaluation TOR summarizes the technical assistance objective as follows: "Review and recommendations for restructuring the Ministry of Finance and Ministry of Economy and other entities involved in fiscal and economic policy, including the Apparat of the Cabinet of Ministers, to enable efficient and effective policy formulation and implementation."

Achievements

Achievements in public administration reform have been significant. But USAID's role in the achievements has been largely limited to the MOE and MOF, and the actual impact of the achievements on operations remain for the future. Public administration reform will continue, and USAID should continue to lend support.

The World Bank is leading public administration reform. The USAID Fiscal Reform Project addressed only that portion of reform relating to the Ministries of Finance and Economy. The USAID Fiscal Reform Project prepared a functional review of the Ministries of Finance and Economy that is consistent with several of the changes made in the organizations of these two ministries. The project also organized study tours to Poland and Estonia to provide guidance on reorganization. A former Minister of Finance of Poland provided extensive comments on the first phase of the reorganization of the MOF.

A number of major changes in the STA, MOF, and MOE resulted from the overall reorganization of the government. The responsibility for tax policy was shifted from the STA to the MOF. The number of deputy ministers in both the MOF and the MOE was reduced from eight to four. Finally, a number of the ministries managing the "real" sector were abolished and their personnel now report to the Minister of Economy. This side of the MOE has been charged with developing markets as opposed to the former ministries' tasks of managing companies and commodities.

The tax policy unit will probably make a major contribution to reform once it is operating. To date, however, the Ministry has been slow to staff the unit. Similarly, reducing the number of deputy ministers has been slow to show results in actual policy reform. However, the reorganization is quite recent.

The Fiscal Reform Project also prepared a strategy to guide the next phase of public administration reform as it pertains to the Cabinet of Ministers and its secretariat. Reform of the secretariat is important, and USAID should support this effort.

Coordination

As indicated, the World Bank is leading public administration reform. Coordination with the bank on this effort appears to be satisfactory. But the evaluation team emerged from the interviews believing

that the bank does not view USAID participation as indispensable. The bank's attitude seems to be that if USAID does not support the effort, someone else will. This attitude could be the basis for reducing USAID involvement in public administration reform if budget reductions are severe. A better strategy would appear to be for USAID to attempt to raise its level of involvement by concentrating on strategic reforms, if this can be arranged. Extending USAID assistance to the secretariat of the Council of Ministers would be consistent with such a strategy.

Local Capacity

Public administration reform has not yet moved to the stage of building local capacity.

Institutional Reform

Reorganization of the Ministries of Finance and Economy is quite recent, too recent for the change to be institutionalized. Many additional reforms will be needed before these ministries operate efficiently under the reorganization and are poised for institutionalization.

3. Recommendations

OVERARCHING OBSERVATIONS

Several overarching observations introduce the evaluation team's recommendations.

Observation: The technical assistance does not distinguish sufficiently enough between short-term policy reform activities and long-term institutional development activities.

The technical assistance program includes activities intended to assist macroeconomic reform in the short term and activities oriented to long-term institutional development. The evaluation team believes that the priority and relationship between these two sets of objectives are not always clear. For example, is the objective in budget process to support the institutional changes necessary for macroeconomic policy reform or to support the creation of a budgetary system that matches international standards? If it is the first, a full complement of institutional change is not needed. If it is the second, a full complement of change is required. The evaluation team understands short-term macroeconomic reform to be the primary objective and long-term institutional development to be secondary. If this is true, in cases of conflict, the requirements of long-term institutional development should be subordinated to those of short-term macroeconomic reform.

Observation: Apparently, technical assistance aimed at capacity building requires a recipient governmental organization to be present if institutionalization is to occur.

System design changes have been implemented through technical assistance, as, for example, in the case of the budgetary system. This seems to have occurred when two items are present simultaneously:

- A recipient governmental organization; and
- Technical assistance aimed at capacity building;

Conversely, when there is no governmental organization present, as is the case with fiscal analysis technical assistance to the Verkhovna Rada, or tax policy assistance to the MOF, the project may produce an immediate result. But the project has no long-term effect unless it is successful in generating a counterpart organization (government or otherwise) to train. When a governmental organization exists but technical assistance is not oriented to capacity building but to providing policy advice, improvement may be slow in coming if the government wants to determine its own policy from alternatives generated by its employees. Therefore, in the future, U.S. assistance should determine if a particular objective can be addressed with advice only or if it requires the transfer of skills to a local institution either inside or outside of the government.

Observation: Technical assistance needs of high priority to macroeconomic reform have not been fulfilled.

Macroeconomic reform requires not only that the good policy alternatives be generated by economic professionals but that a decision-making system be in place that will allow the alternatives to be appropriately processed. Such a system does not appear to be in place. The evaluation team heard in interviews that government officials are interested in putting such a system in place. Candidates for such reform are the top levels of the Ministry of Economy, the Cabinet of Ministers (secretariat), the Office of the Prime Minister, and the Office of the President. USAID may wish to explore opportunities for decision-system technical assistance in these candidate organizations.

MACROECONOMIC ASSISTANCE

Financing the provision of macroeconomic advice is a little like buying a stereo system. One does not ask how much it costs to hear music in stereo. Rather, one looks at his or her budget knowing that for \$100 you can buy one that plays music, but for \$1,000 you can buy a much bigger one that plays music with better quality and higher volume. Similarly, a small budget gets you a small part in the macroeconomic reform effort while a larger budget gets you a larger part.

Observation: The amount of USAID resources spent for untargeted direct macroeconomic advice is too small to make a difference.

If HIID is viewed as USAID's principal effort to provide macroeconomic advice, the level of effort is small compared with the level of effort of the IMF and the World Bank. It is also small compared with the other main assistance provider under SO 1.2 (Barents). Not only is the HIID budget a minority portion of the funds supporting SO 1.2, but also HIID has made direct assistance to the government a relatively less emphasized component of its overall activity. We were told that direct assistance represented only about 25 percent of HIID's effort in Ukraine, down from 50 percent, as a result of its own assessment of needs. In specific areas of interest to HIID, such as pension reform, USAID is already funding more targeted technical assistance. Finally, problems in releasing funds to HIID have affected its ability to provide a consistent level of advice. At present or reduced budgetary levels this kind of untargeted direct assistance is not worth continuing.

Observation: USAID should avoid funding activities that conflict with U.S.-supported IMF, World Bank, and other USAID activities.

A second consideration with regard to a HIID-like assistance package is the following. Economics does not always provide a singular solution to a particular problem, and wide variations occur in analyses depending on assumptions, data, and the perspective of the analyst. We have heard a number of people say that the GOU needs to see and understand that there are choices to be made for most policy objectives. This is correct. But insofar as the choices are not fully developed or presented by the IMF, the World Bank, or a more targeted technical assistance activity financed by USAID or other donors, positioning HIID to play this role is unfair to HIID and to the overall effort. Perceived shortcomings in the recommendations of the IMF and the World Bank should be addressed by their boards of directors and not at the field level.

Similarly, USAID's project management should be competent enough to determine if a particular technical assistance contractor is adequately explaining the options to its counterpart. From this perspective, where HIID reached conclusions that differed from those of another assistance provider, the differences should have been worked out with the funding agency and not presented as a policy

choice for a government official who does not have the staff and training to assess the choice. If a particular IMF or World Bank conditionality is inappropriate or there is a better way to accomplish the objective, it is frankly too late to visit the issue once the IMF and the World Bank have obtained the approval of their board of directors. It may be that the U.S. Government is not sufficiently staffed to analyze each of the details of the IMF and World Bank programs so that the problems are resolved at the level of the board of directors before the programs are approved. This, however, is an internal U.S. Government issue. But it is inappropriate for the U.S. Government to approve an IMF or World Bank program at the board of director level and then fund an activity that potentially may result in conflicts with those programs after they are approved.

The above discussion should not be construed to imply that the U.S.-funded assistance providers should not help the IMF and the World Bank design their programs. The on-the-ground knowledge of these groups is frequently an invaluable input to the IFIs' programs. In this regard, HIID's work in data collection and analysis has been requested by IFIs as programs are under design.

Observation: There is a need for more targeted, direct, and confidential technical assistance.

The MOE has an important responsibility to monitor economic developments in order to inform the cabinet, the prime minister, the president, and the parliament. It also prepares the annual plan for the government that states which reform measures the GOU will undertake during the year. Both of these functions are important to carry out an orderly and transparent reform. The U.S. Treasury macroeconomic adviser is conscientiously engaged in helping his counterpart improve these functions. He, or at least the function he performs, should continue and his work should be enhanced by a complementary and concerted effort in MOE staff development. Training could include a condensed course in economics and specialized seminars, workshops, or short courses on topics such as "How to write a policy paper," "How to write an options paper," and "How to distill analyses for briefing senior management." In addition, management courses analogous to USAID's mid- and senior management courses would be helpful.

Observation: The CASE modeling effort should be continued at a maintenance level only.

The modeling effort carried out by CASE is successful to the point where better numbers are available in preparing the budget. Given the resource constraints, the time it would take, and the appearance of the Canadians, it would be pointless to continue the effort to train the MOE staff to be able to adjust the model. The Canadian model will not be ready to take over the forecasting task for the next several years, but the need for sound estimates will be exceedingly important as the government continues to tighten its grip on the budget. Consequently, there is a need to continue support of the CASE model at a maintenance level until the Canadian model is fully operational.

Observation: USAID should investigate whether MOE functions related to industry, energy, transportation, and trade require assistance.

The MOE has other functions particularly related to the absorption of former line ministries such as industry, energy, transport, and trade. This side of the MOE's house is now charged with developing markets in goods and services formerly under tight control of the government. In many instances these include the kinds of markets which, in advanced market economies, are subject to government oversight and regulation. It is crucial to investigate the needs of this side of the MOE before it

develops new laws and regulations in the absence of a clear understanding of the role of oversight and regulation in a market economy. There is a good chance that if left unassisted, the MOE could issue regulations that will have to be undone in the future. In this regard, USAID may already have sufficient assistance instruments available and dispersed within its program. What is recommended here is to assess the situation and organize the effort within USAID to determine if a supplementary effort is needed.

Observation: USAID should support GOU efforts to create an economic policy advice center.

In the later stage of our interviews with Ukrainian officials, we were informed of a concept being discussed at the highest level of government to create an “advice center.” The concept appeared preliminary in its development. We believe it offers a potentially valuable tool for the government to better plan and execute its reform program and is worth further investigation and support. Without helping to shape this concept, there is a danger that the GOU may institute a donor advice clearinghouse (these words were mentioned) that could result in the GOU attempting to coordinate the donors.

A center would be of value if it had certain responsibilities and characteristics. First, the center should be a source of confidential and high-quality advice to the highest level of government including the president and his staff, the prime minister, the governor of the central bank, and perhaps the MOF and the MOE. Consideration should also be given to giving the Cabinet Secretary access.

Second, the center should not replace an existing responsibility of any of the ministries, but would crystallize analyses and recommendations coming from them for the senior executives managing the reform. In certain cases, such as tax policy, the center, in the immediate future, would have to carry the burden for that function since the MOF is unprepared to carry out that function now. The center would also digest the various analyses and recommendations of the donors and help the government through the negotiations and decision-making processes associated with recommended policy actions.

The center should be seen as a temporary tool for the crucial period ahead. It should be fully capable of carrying out its functions immediately after start-up. From this perspective, there would be no need to distract its staff from the principal advisory role with an institutional development objective. Much like the U.S. National Security Council and the old Council of Economic Advisors, there is no need for permanent staff at this level. In fact, there are real benefits to having rotating staff. To a certain extent, the FAO as now functioning for the Verkhovna Rada has some parallels to this proposed concept for a center. A more specific example was the Government of Indonesia’s (GOI) hiring of HIID, exclusively under GOI finance, to provide this kind of service to the senior minister for economic affairs and the governor of the Central Bank of Indonesia. Another example at a lower level of government was the USAID financing of KPMG/Peat Marwick advisers to work with the Ministry of Finance in Egypt on tax policy and administrative reform.

A public information and awareness program should continue. But if a U.S. institution is involved (which would appear to be needed over the next three years) it should be paired with a local institution such as ICPS. Indigenous public policy institutes need strengthening and linkages to outside institutions.

Observation: Assistance to training should be targeted to economics at the undergraduate level.

Training at all levels is essential. But the most important level for the long-range health of Ukraine's economy is training at the undergraduate and graduate levels in economics, public administration, and business administration. The graduate economics program at Kyiv Mohyla Academy is good and deserves continued financial support. Creating additional programs in other cities would be useful but it would be unwise to do this within the USAID country OYB since annual changes in its level would jeopardize the stability of the graduate program.

In the near term, the provision of a condensed and focused course in market economics would be quite useful for the economics teaching faculties at Ukraine's undergraduate schools. These institutions are providing the foundation education in economics to the next generation of Ukraine's economics thinkers. At present, the teaching staffs are essentially self taught in market economics. This is an important in-service training opportunity that need not involve the kind of long-range financial commitment required to institutionalize a graduate program. It could be only a three-year effort.

TAX POLICY AND ADMINISTRATION

Tax reform is of immense importance in a successful transition to a predominantly market-directed economy. Most students of the process would also agree that in the sequence of policy reforms that are needed for a successful transition, tax reform comes near the top. The reason was put forth in the introduction to this report. While the role of the government in production diminishes substantially, its role in the provision of public services increases substantially. Thus any expectation that, early in the transition, the absolute size of government can decline significantly is likely to prove unrealistic. And if the size of government is not reduced, then its share of the income generated by way of production cannot be significantly reduced. The hyperinflation that characterized so many of the former Soviet economies immediately following the dissolution of the union, can be largely attributed to the failure to recognize, and to act on, the need for an early and major tax reform.

Technical assistance for tax reform should emphasize both tax policy and tax administration, and the effort should be carried out at a high level of government. As indicated earlier, tax reform programs can ill-afford to emphasize policy to the exclusion of administration, or administration to the exclusion of policy. The two are important complements. That is why the successful comprehensive tax reform projects that have taken place around the world have almost always, if not always, included economists, lawyers, and hands-on tax administrators working together as a team. Tax policy and tax administration reform do not lend themselves to sequential implementation. Close coordination is essential.

As noted in Chapter 2, Findings, numerous U.S. Government-funded TA activities have been carried out in Ukraine since approximately 1993. The existing Barents contract and the U.S. Treasury Advisers program are extensions of TA in support of tax reform that began seven or more years ago. Many of these activities have been relatively successful in the sense that the inputs were deployed in directions where there were problems that needed to be solved. TA has been delivered to the Ministry of Finance, the Ministry of Economy, the State Tax Administration, the Tax Militia, Verkhovna Rada, and, though not on a regular or systematic basis, even to the administration of the President.

Despite all this “help,” aggregate data on the budget and its financing do not show the improvement that might reasonably be expected. As real GDP has declined, tax collections in 1999 did not hold the share of nominal GDP they represented in 1995. The idea of a significant bundle of TA resources being used on tax reform, and not even managing to hold the tax share of GDP, suggests that highly effective tax reform did not exist. The conclusion we have reached is that tax reform has not had the kind of high level attention it must have in order to take place.

Because we deem tax reform so critical to a successful transition, we do not believe it should be abandoned without an additional effort to make it work. However, we do not believe it is likely to be successful the way the TA is fragmented and distributed around multiple agencies now. Moreover, in the abstract, we believe that the Ministry of Finance would be the place to center the tax reform effort. But, for a variety of reasons, we doubt that the Ministry of Finance could muster the political or bureaucratic strength in the immediate future to overcome the obstacles to reform that are represented by present stakeholders in other ministries, in the STA, and other points inside and outside of government. To accomplish that, we are convinced that the reform effort must be centered somewhere above the level of the spending ministries, as in the Office of the Prime Minister or of the President. And the person in charge of making the reform happen must hold sway over the many other staff and line ministries that have become stakeholders of one kind or another. The TA team serving as staff to the unit would include both tax policy and tax administration.

A tax reform technical assistance team should have strong technical qualifications but need not have experience with the GOU's tax system. As a general matter, tax reforms are usually more likely to succeed if the reform is directed by a team selected for the purpose, and one that does not have a long history of interest in the tax system. If, for example, the prime minister should be designated the tsar of tax reform, he should be provided with a team of extraordinarily highly qualified technical specialists, who have neither a background in the Ukrainian tax system nor strong ties to such people. The leader of tax reform should also have an advisory group of the ministers of the ministries that will have to be involved. But they should not be equal partners with him or her, as he must be able to serve as a tie breaker on issues on which they disagree. This is the consideration that makes the prime minister seem a plausible choice.

In another section of this report, we have recommended that such a strong, centralized unit be created and charged with leading the overall economic reform effort. The proposal here does not compete with that proposal. It simply puts some flesh on one of the specific assignments the senior official would undertake. It is our judgment that tax reform is of such importance that it would represent a major proportion of the reform program. The unit we envisage would also take on responsibility for reform of external debt management and policy, as well as fiscal policy, but not for monetary policy. Conceivably, it could also take on competition policy and financial sector policy other than monetary policy. (This would include, however, such matters as prudential requirements for financial institutions.)

The foregoing proposal is a little radical. But the problem of economic reform in Ukraine is of prime importance. Assuming the pending IMF audit report does not reveal serious problems, a program of this intensity might well be possible. It is our impression that most close observers of the Ukrainian system believe that the present government has the broad and deep popular support, and the strong leaders, to make it work. It could easily consume more funds than have been allocated to macroeconomic and fiscal TA in recent years. It is not the kind of program that a government could

be “talked into.” But it could be the core of a genuine assault on the deep economic malaise into which the country has slid for a decade. Assuming that the government of President Kuchma and Prime Minister Youschenko should consider such a possibility and then ask for it themselves, coming up with the specific space, the specific and appropriate counterparts, and then staking something of their reputations on making it work—in advance of the funding—it could work.

OTHER FISCAL AFFAIRS

This section provides recommendations for a technical assistance program over the next four years. The recommendations are limited to budget process, treasury management, fiscal analysis for the parliament, intergovernmental finance, and public administration reform. The five activities are ranked in order of priority to receive technical assistance, highest first. Recommendations concentrate on recommended actions for USAID, but a role and actions for other donors are presented when appropriate.

A strategy for macroeconomic reform guides the recommendations. The strategy is to expand the reform effort, moving it deeper into the Ministry of Finance, as in the Priority 1 recommendations, and beyond the Ministries of Finance and Economy into selected strategic decision-making bodies, as in Priority 2.

Priority 1: Budget Process

The strategy recognizes that the short-term objective is macroeconomic reform, and to achieve this objective donor assistance should enter a new phase. The phase of systems design and implementation has been successfully completed; the phase of institutionalization and operations improvement is beginning. The function now performed by the U.S. Department of Treasury adviser should lead the next phase with USAID contractor assistance providing complementary training to improve the operation of the budget system.

Senior Adviser Role

- ***Clarify the role of the senior adviser.*** The U.S. Treasury has provided a senior adviser experienced in using budget systems to accomplish operational goals. This function is a key activity for the next phase of assistance. The Treasury adviser is not a technical systems design specialist. He should be used by top MOF budget officials to help them accomplish their goals using the new budget system. He should have access to the deputy minister, the head of the Main Budget Department, and other top MOF officials and an office befitting such a senior adviser. (If he is not going to function as a senior adviser, does the Treasury want to spend the money for his services?) The adviser, with the help of senior U.S. officials should clarify his role in the MOF.
- ***Until the Verkhovna Rada has approved a budget code, confirm that the Presidential Decree provides all the authority necessary for the Main Budget Department to be aggressive in budget preparation.*** Senior officials should confirm with top MOF management that the Presidential Decrees on budget preparation provide all the authority that is needed for the Main Budget Department to be aggressive in executing the policy laid out in the decrees and that

constant reiteration by MOF management is not needed. This confirmation would help the adviser formulate appropriate advice—it would clarify what MOF is attempting to accomplish.

- ***Win approval for the sector departments to participate in executing the Presidential Decree.*** The sector departments should not protect the spending agency budgets but should assist the Main Budget Department. This should be official and explicit MOF policy.
- ***Advise the Main Budget Department to be aggressive.*** The resident adviser should use the above, if accomplished, to suggest aggressive steps in budget preparation. This would include explicit advice for MOF to discard norms and standards in budget preparation.

Contractor Role

- ***Focus assistance on training.*** Two areas of training are critical. The sectoral departments should abandon the norms and standards approach to budgeting. The new system needs expertise to identify expenditures that are inconsistent with a market economy and to develop expenditure reduction strategies that reduce the social pain to politically acceptable levels. Personnel in these departments should be brought into the system, and they will need training to play their new roles effectively. The training should explain the new system, the role that these personnel are to play in it, the objective of their efforts, and techniques of analysis that they can employ. The techniques of analysis should emphasize the short-term objective, major expenditure reduction, rather than generalized analysis. Interviews suggest that the training will be more effective if provided by a Ukrainian organization. A place to begin might be the International Centre for Policy Studies, using the approach developed by RAND. Over the longer term, this training should also be provided to the sector departments of the Ministry of Economy and to managers in the spending agencies.
- ***Train budget examiners.*** Budget examiners in the main Budget Department and spending agencies will need similar but less strategic training. Large numbers of personnel are candidates, and the need will be continuing. The resident and regional U. S. Department of Treasury advisers are currently devising a program of training, and their work might provide the material for the program. An indigenous training capability should be developed to provide this training, and developing this training capacity should be the focus of USAID technical assistance. (Training of junior examiners in the Main Budget Department will continue.)
- ***Continue system development support to the MOF intranet data system.*** An information system for all of MOF is currently being developed. USAID support for this effort should continue. However, USAID should require that the system development consultant produce and adhere to a plan for completing the system design and quickly turning over operation of the system to MOF personnel.
- ***Support the senior adviser with appropriate assistance.*** The U.S. Treasury adviser has some resources in his budget that permits him to call on short-term Treasury advisers. These funds may not be sufficient or may be difficult to access on short notice. The contractor should have some capacity to address the senior adviser's needs as the Mission budget permits.

The U.S.-financed assistance outlined above will be working in a reform environment largely dictated by the IMF. The IMF, in fact, has the resources and the precedence to provide the senior adviser to the budget side of the MOF. However, it does not provide the complete package of assistance as described that is needed for the budget system to work properly in support of the reform and to be compatible with the needs of a market economy. Whether the IMF or the U.S. Treasury or a USAID contractor provides the senior adviser, the U.S. assistance program managers need to ensure that there is close coordination between the IMF agenda in Ukraine and the work of the senior adviser and supporting assistance activities.

Our sense is that the IMF staff in Ukraine today would support coordination with this activity. However, members of the evaluation team have observed in other countries less willingness on the part of the IMF to appreciate or rely on bilateral donor assistance in the implementation of key features of the IMF's reform agenda for that country. In the case of the Ukraine, the evaluation team encountered a document entitled *IMF Public Expenditure Review* that could provide one basis for budget preparation. It is important that a document such as this be shared with and explained to the U.S. Treasury adviser so that his work builds on the work being done by the IMF.

Priority 2: Public Administration Reform

The World Bank has a project in public administration reform and, by definition, will take the lead in this project—but not necessarily in strategic reform. As indicated in Chapter 2, Findings, the need for strategic reform does not appear to be adequately covered. Support to strategic reform is short-term oriented; support to the World Bank program is long-term and institutionally oriented.

USAID should be sure that the most critical aspects of public administration reform are covered and receive appropriate priority, regardless of which donor or project leads the effort. An appropriate decision-making system for top officials is critical to policy reform. USAID should ensure that such a project is undertaken, even if the project is not part of the World Bank public administration reform effort. (the government must agree to such a project.)

- ***Explore the need for a public administration project.*** USAID should satisfy itself that the international technical assistance effort will, as a priority, provide the president, prime minister, and cabinet with strong, institutionalized staff support. If the need exists (and agreement), USAID should launch a project to reform existing staff operations and provide, at minimum, an improved decision-making system. An abbreviated institutional development effort concentrating on organizational structure, staffing, and systems and procedures related to decision making is contemplated.
- ***Continue to support the World Bank project in the Ministries of Finance and Ministries of Economy.*** Support in these ministries is not complete; USAID should continue to provide support. However, the World Bank project appears to be administratively rather strategically oriented. For example, budget preparation does not appear to receive the proper emphasis in the list of MOF duties. Individual ministers need strategic management systems that include strong decision making. USAID should ensure that these systems are put in place in the Ministries of Economy and Finance. As a long-term effort, comprehensive institutional development that

includes design, implementation, and coaching of operations should be executed. The institutional design should consider

- Strategic guidance, including a mission statement and available strategies and policies;
 - Organizational structure;
 - Staffing plan
 - Systems and procedures;
 - Facilities and equipment;
 - Budget; and
 - ? External relationships and linkages.
- ***Provide training for staff who are subjects of the preceding two efforts.*** Staff who are subjects of decision-making reform projects and strategic management systems projects should be sent to a center of policy excellence-type program as a matter of some priority.

The World Bank appears to regard itself as the lead agency in public administration reform. If USAID verifies an unfilled strategic need, the World Bank will probably want to move into the area. With its resources, that would be appropriate. Therefore, the USAID effort might be expected to be limited with the World Bank assuming leadership after, perhaps, two years.

Priority 3: Treasury Management

USAID-provided technical assistance for treasury management should not impose a heavy budgetary burden, but the payoff in terms of a close link between the budgeting and accounting systems could be significant. Support to treasury management is long term and institutionally oriented.

The IMF resident adviser will lead the effort to define the need for USAID-provided technical assistance. As far as the overall reform effort is concerned, however, he should review the need for accrual accounting. The operational need for budget preparation is for cost accounting to provide a firm basis for budget estimates, given the demise of norms and standards. The operational need for budget execution is for obligational accounting to avoid arrears and the commitment to liabilities for which there is insufficient revenue. As a point of information, in Vietnam the IMF has cautioned against accrual accounting as being more sophisticated than needed in the early stages of reform.

Recommendations for Priority 1 include continued USAID systems support to build the MOF intranet. This assistance implies an effort to link the budget and accounting systems. Priority 1 technical assistance should *support Treasury systems development as requested and as funds are available*. Alternatively, in view of the government's preference not to use loan funds for technical assistance, USAID could become the main provider of system development support, if the budget permits.

Priority 4: Intergovernmental Finance

The central recommendation is to continue intergovernmental financial advice but reorient it. This assistance would be long term and institutionally oriented. USAID would continue to be the primary provider of assistance. The assistance would be for systems development, capacity building, and

long-term institutional reform. A short-term contribution to macroeconomic reform would not be expected. If it occurred, the assistance would have provided an unexpected benefit.

- ***Transfer assistance to the Executive Branch and specifically to the Tax Policy and Macroeconomic Forecasting Department in MOF.*** Assistance is provided by one expatriate professional. This level of effort should be continued, but the focus of the assistance should be transferred from the Verkhovna Rada to the Executive Branch, which is much more likely to be responsive to advice. The preferred Executive Branch location is the Tax Policy and Macroeconomic Forecasting Department in MOF. The prime minister's office would be an acceptable alternative, in line with other recommendations in this report.
- ***Build local capacity.*** As pointed out in the introduction in Chapter 2, Findings, capacity building technical assistance should begin only when a counterpart organization exists to receive the assistance. Given a counterpart organization, the purpose of the assistance should be to develop Executive Branch capacity to perform intergovernmental fiscal policy analysis. The consultant should prepare and adhere to a plan to develop the capacity and to turn it over to the government for operation.
- ***Establish as a condition of assistance that any capacity developed for formula transfers be responsive to Verkhovna Rada information requests.*** There is no need to develop separate technical capability to execute formulae. If the Verkhovna Rada supplies the parameters of a formula, the Executive Branch should be able to execute the formula as a matter of courtesy and to build bridges of cooperation.

Priority 5: Fiscal Analysis for the Parliament

USAID should continue to fund the FAO but should not expect direct tangible benefits from the investment. This assistance would constitute a long-term investment in a more democratic society and a stronger parliament. USAID would continue to be the provider of assistance, which would be for operational support. The FAO itself is institutionalized and can operate without further technical assistance; therefore, USAID would serve only as a funding mechanism.

- ***Continue to provide existing services to mitigate against bad legislation and as a reminder to the Verkhovna Rada of the need for professional services.*** FAO analyses can contribute to the Verkhovna Rada's rejection of weak legislation, and this would be a substantial benefit. (In doing so, FAO would be in a staff operating role, and one can question why the American taxpayer should pay for Verkhovna Rada staff.) Such benefits could remind Verkhovna Rada members of the need for good professional staff so that, if and when the Verkhovna Rada is disposed to do so, it can create a staff of its own. It is unlikely that the benefits will be more direct. When asked for the most important future activities, the FAO provided the following list. (Evaluative comments have been added.)
- ? Ensure absorption into the Verkhovna Rada. As indicated by Verkhovna Rada committee chairmen, this will not happen for at least two years.

- Transfer technology to Verkhovna Rada staff. There is no Verkhovna Rada counterpart staff for the FAO to whom technology can be transferred.
 - Assist in implementing the budget code. The code has not passed. There is no guarantee that it will; and, if it does, it will probably not suffice as law for long. Implementation assistance would not be highly productive.
 - ? Become a think-tank for the oblasts. This is an operational role and not appropriate for USAID funding. If it is valuable, the government should fund it out of its own sources, including international donor general budget support.
- If USAID were to fund FAO for three additional years, the Verkhovna Rada's inclination to make FAO a permanent legislative staff would have been sufficiently tested. The Verkhovna Rada will more likely make FAO a permanent staff if FAO serves all the parliament rather than the budget and finance committees.
 - *Transfer FAO to an NGO.* If the Verkhovna Rada does not incorporate FAO into its permanent staff, USAID could attempt to identify a Ukrainian NGO that would assume responsibility for FAO and provide funding.

Appendix A

**PERSONS
INTERVIEWED**

PERSONS INTERVIEWED

WASHINGTON, D. C. APRIL 3—APRIL 7, 2000

USAID

Don Pressley
George Ingraham
Robin Phillips
Laurie Landy
John Crihfield
Alexander Shapleigh
Charles M. Mohan (on TDY from USAID/Kyiv)

State Department

Ambassador Bill Taylor
Douglas Wake

U.S. Treasury Department

Mr. Robert Klayman
Mr. Robert E. Warfield
Mr. Kenneth H. Torp
Mr. Gary Michael Lazor
Mr. Dean E. Ergenbright
Elizabeth Berko
Scott Melese

NSC

John E. Tedstrom

KPMG/Barents Group

Francis P. Greney
Harvey Galper

Ukrainian National Information Service

Michael Sawkiew

Tarnara Gallo

Ronya Lozynskyj

CAMBRIDGE, MASS., APRIL 7, 2000

Harvard Institute for International Development (HIID)

Joseph Stern

Alexander Pivovarsky

BUDAPEST, APRIL 7, 2000

U.S. Department of Treasury

W. David Darby

KYIV, UKRAINE, APRIL 8—29, 2000,

DONOR AGENCIES, CONTRACTORS, AND OTHER ASSISTANCE PROVIDERS

USAID

Christopher Crowley

Paul Mulligan

Earl Gaste

Elinor Bachrach

Chuck Mohan

Peter Luzik

Judith Schumacher

Sherry Grossman

Hugh Haworth

U.S. Embassy

John Bowen

Steven Zate

U.S. Treasury Advisors

Victor Zafra
Paul V. Bruning
Scott McLeod
Alan Robidoux

IMF

Henri Ghesquiere
Michel Marion
Janis Platais
Martin Petri
Blaine McDonald

World Bank

Dusan Vujovic
John Hansen
Svetlana Budagovskaya

TACIS

Murice Downey
Jean-Paul Blandinieres

International Center for Policy Studies

Vira Nanivska

Center for Social and Economic Research (CASE)

Marek Dabrowski
Miroslaw Gronicki
Gennadiy Greblov
Malgorzata Markiewicz

Harvard Institute for International Development (HIID)

Janusz Szyrmer
Khwaja Sultan
David Snelbecker
Vladimir Dubrovskiy
Dimitar Georgiev Mishev
Olga Ruda

Andrzej Jarzynowski
Zhanna Bunina
Viktoria Gnatkovska
Liliana Pasyeka

Barents Group

Richard Laliberte
George Ianev
Gilles Paquin
Victor Chepenko
Vlad Khlysturn
Monique Courchesne
Charles Shea
Joseph Burke
Hans Hoogeveen
Eric Lickman
Artern Rudick
Youuri Kesiuk
Andriy Donchenko
Ihor Shpak
Wayne Thirsk
Katherine Kanyuk

Economic Education and Research Consortium

Michael Blackman

KYIV, UKRAINE. APRIL 8—29, 2000, GOVERNMENT OF UKRAINE

President's Office

Mr. Lanovoiy

Ministry of Finance

Vasily Geguretsky
Anatoli Maksyuta
Ms. Feshchuk
Ms. Smoyar
Mr. Myarkovsky
Ms. Ushakova

Ms. Smolyar
Ms. Shapovalova
Mr. Kovalchuk

Ministry of Economy

Ihor Shumylo
Mr. Shlapak

Ukrainian Treasury

Mr. Bonislavsky

State Tax Administration

Mr. Yaroshenko
Mr. Operenko
Mr. Merkulov
Mr. Shytrya
Ms. Kosminan
Mr. Furman
Ms. Danilyuk
Ms. Flissak
Mr. Semerha

Verkhovna Rada

Mr. O. Turchynov
Yevhen Zhovtyak
Valeriy Alyoshin
Andriy Grytsenko
Ceasar Ohon

Others

Alexander Paskhaver (Center for Economic Development)

Appendix B

**DRAFT SCOPE OF
WORK**

Draft Scope of Work

The Statement of Work for this evaluation required that;

...the Consultant shall prepare a draft report that provides advice on activities to be assigned the highest priority and recommendations on the mix of U.S.A.I.D. technical assistance and other inputs for a combined program that will best serve Ukraine's needs and the Mission's strategy in the areas of fiscal reform and macroeconomic policy, taking into account the prospective role and requirements of U.S. Treasury advisors and of other international donor organizations. The recommendations should provide options based on the following assumptions:

- funding at FY 1999 levels
- 25% reduction
- 50% reduction

In addition, under the Deliverables section of the Statement of Work, the following item was requested.

3. Draft scope of work covering a three to four-year period for one contractor to implement U.S.A.I.D. fiscal reform and macroeconomic policy activities, including suggested benchmarks and performance measurements.

This annex presents the evaluation's Chapter V recommendations in accordance with the above Statement of Work requirements. Under each heading (Macroeconomics, Tax Policy and Administration, and Other Fiscal Reform Areas) the recommendations have been prioritized. This approach permits U.S.A.I.D. to fund what it feels is an appropriate level starting with the first priority recommendations and going down the lists as the budget permits. The priorities have been segregated under the three main topics because the Mission, with far greater experience with Ukraine's needs is better placed to determine which of the first priorities in each category is the first among them for funding.

The team's impression is that tax policy reform is a truly urgent need. However, we recognize that the urgency of this need arises from the relatively less attention paid to this area by the GOU. Should the Mission choose this topic as its highest priority and should the GOU continue to de-emphasize this area, little funds are needed to maintain a technical assistance presence. However, if the GOU becomes seriously interested in fixing the problems in tax policy and law, a U.S.A.I.D. support effort could capture a significant portion of the funds available in FY 2001. For this reason, two scenarios are presented under tax policy and administration.

MACROECONOMIC ASSISTANCE

Priority 1

Macroeconomic technical assistance to the First Deputy Minister of Economy. Continue the presence of the Macroeconomic Advisor to the First Deputy Minister of Economy. This advisor should focus on improving the policy, analytical, and reporting functions of the Deputy. Provide for direct training for the economic analysis/reporting staff and the annual and strategic planning staff. Promote the publication of data and analysis by the Ministry. Support the forecasting activity in the MOF at a maintenance level until the Canadian aid is operational.

Priority 2

Strengthen non-government organizations in their efforts in public policy. Identify several NGOs involved in supporting/promoting public policy. Help them obtain and analyze data and materials which they can use to improve the scope and depth of the public's understanding of the reform and the policy choices which can be made. Assist the identified NGOs organize and conduct public seminars, lecture series and informational campaigns. Assist the identified NGOs prepare, publish and distribute data, analysis and studies to appropriate individuals, universities, and government and private offices in the Ukraine. Assist the identified NGOs in becoming a resource center for advisors, policy analysts and others inside and outside of Ukraine.

Priority 3

Support economics training at the undergraduate level through in-service teacher training. Prepare materials for a series of short courses on macro- and microeconomics, and special topics such as public finance (e.g. tax policy, fiscal federalism), international trade, international economic organizations, labor, econometrics, and research methodology. Courses could be designed to be offered at night, during school breaks, during in-service teacher institutes and by correspondence.

Priority 4

Investigate and be prepared to support the MOE's responsibility to "develop" markets. (This recommendation is relatively low because the Mission may already have sufficient programs to carry out this recommendation. Also, since it would, to some extent, be a new activity, the Mission may be able to identify another donor to provide the primary assistance contractor).

Priority 5

Investigate and be prepared to support the President/PM's concept of a "center". (The relatively low priority of this recommendation reflects the very preliminary nature of the concept as discussed with the evaluation team. Should the idea be fleshed out along the lines suggested in Chapter V Recommendations, the priority of this activity should rise).

TAX REFORM

Scenario 1

GOU signals its unequivocal intention to pursue a strong, coordinated and comprehensive tax reform program. Such a signal could include the creation of a high level directorate for tax reform chaired possibly by the Prime Minister or his designee and including the Minister of Finance, the Head of State Tax Administration and/or others as directed by the Prime Minister.

Priority 1

A highly qualified technical assistance team should be assembled under a single director to serve as technical staff to the high level GOU Directorate. The technical assistance team should be headed by an internationally esteemed economist with broad practical experience in directing comprehensive tax reform. It should also include highly qualified lawyers and specialists in tax administration. Having the team together is essential, as policy-administration-legislation are inseparable at this stage of Ukraine's economic transition.

The technical assistance should have a specific finite life, ending at the time the reform is scheduled to be completed. Within 6 months, the GOU Directorate should be required to present its detailed plan for the reform of policy, administration and legislation (as needed) in each of the main tax areas. During this period, the IMF and World Bank programs would continue to be implemented.

Scenario 2

No change in the GOU's seriousness in tax reform.

Phase out tax policy technical assistance. Phase out Intergovernmental Revenue assistance on the tax side. Within 3 months, U.S.A.I.D. obtains an assessment of tax administration technical assistance that is independent of Policy Reform **and** that World Bank funding will not support. All other technical assistance in tax administration would be canceled.

BUDGET PROCESS

Priority 1

Develop a Ukrainian-run training program for sectoral department personnel of the Ministries of Finance and Economy that will prepare these staffs to assist the Main Budget Department formulate a budget that is based on the new budgetary system and techniques and is consistent with Presidential Decrees on Budget Preparation.

The sectoral departments should abandon the norms and standards approach to budgeting. The new budgetary system needs their expertise to identify expenditures that are inconsistent with a market economy and to develop expenditure reduction strategies that reduce the social pain to politically acceptable level. Personnel in these departments should be brought into the system, and they will need training to play their new roles effectively. The training should explain the new

system, the role that they are to play in it, the objective of their efforts, and techniques of analysis that they can employ. The techniques of analysis should emphasize the short-term objective, major expenditure reduction, rather than generalized analysis. The training will be more effective if provided by a Ukrainian organization.

The consultant is expected to conduct a needs assessment and identify the numbers and types of personnel in the Ministries of Finance and Economy to be trained. Required training program content should be defined and materials prepared to provide the content and accomplish the training objective. A Ukrainian institution should be identified to provide the training and an agreement executed to do so. The consultant is expected to assist the identified institution prepare a training strategy, including a training schedule, to meet the training objective and to train trainers for the identified institution. The consultant will coach the identified institution in executing the strategy, as required for the program to be successful.

Priority 2

Develop a Ukrainian-run training program for budget preparation personnel of the Ministries of Finance and spending agencies that will prepare these staffs to assist the Main Budget Department formulate a budget that is based on the new budgetary system and techniques and is consistent with Presidential Decrees on Budget Preparation.

Budget examiners in the Main Budget Department and spending agencies will need similar but less strategic training. Large numbers of personnel are candidates, and the need will be continuing. The resident and regional U. S. Department of Treasury Advisors are currently devising a program of training and their work might provide the material for the program. An indigenous training capability should be developed to provide this training. (Training of junior examiners in the Main Budget Department will be continuing.)

The consultant is expected to conduct a needs assessment and identify the numbers and types of personnel in the Ministries of Finance and spending agencies to be trained. Required training program content should be defined and materials prepared to provide the content and accomplish the training objective. A Ukrainian institution should be identified to provide the training and an agreement executed to do so. The consultant is expected to assist the identified institution prepare a training strategy, including a training schedule, to meet the training objective and to train trainers for the identified institution. The consultant will coach the identified institution in executing the strategy, as required for the program to be successful.

FISCAL ANALYSIS FOR THE PARLIAMENT

Priority 3

Provide support, including funding, for the Fiscal Analysis Office. Macroeconomic policy reform does not require parliament to be able to develop its own policy alternatives and select from among them. It does require, as does democracy, that the parliament understand the policy presented by the Government, approve that policy if it agrees, and then hold the Government accountable for execution of that policy. The Fiscal Analysis Office (FAO) is a U.S.A.I.D. funded staff operating

externally to the parliament. It seems to gather data and present and describe the data for better understanding. This is supportive of macroeconomic reform; for, if used by the parliament, these documents can assist its members understand the Executive Budget so that approval can be given or changes can be requested and so that control, matching the approved budget to actual results, can be exercised. However, A distinction should be made between the formulation of and the evaluation or critique of policy. FAO does not appear to be well positioned to perform the former, but it can and has performed the latter. Given this capability, the FAO can potentially contribute to preventing the parliament from passing bad legislation. By a process of elimination, good legislation may then pass. Members of the parliament's Budget and Banking and Finance Committees do confirm that the FAO is helpful to them. One can conclude, therefore, that the FAO is playing a useful role in the policy reform process.

Leadership of the two committees have stated unequivocally that the FAO will not become the parliament's staff for at least two years. Personnel reductions in the Executive Branch are to be replicated in the parliament, and the Verkhovna Rada will not agree to fund the FAO while it is reducing its current staff. If U.S.A.I.D. were to fund the FAO for three additional years, the Verkhovna Rada's inclination to make the FAO a permanent legislative staff would have been sufficiently tested. The Verkhovna Rada will more likely make the FAO a permanent staff if the FAO serves all the parliament rather than the budget and finance committees.

Therefore, the consultant is expected to provide the FAO for the three to four year's of the contract. In return, the FAO will continue to provide services to the Verkhovna Rada, but in each of the first two years will increase the proportion of its services that it provides to non-members of the budget and finance committees. In the third year, the consultant will convey to the chairman of the budget and finance committees and to Verkhovna Rada leadership that the consultant and U.S.A.I.D. will cease funding FAO at the end of the third year. If the Verkhovna Rada wishes to continue to avail itself of the FAO services, it should absorb the FAO as a permanent staff of the Verkhovna Rada.

During the third year, the consultant will attempt to identify a Ukrainian NGO that would be willing to absorb the FAO and provide funding. If the Verkhovna Rada does not absorb the FAO in the third year, the consultant will work with the identified NGO to transfer responsibility for the FAO during the fourth year, to be completed by the end of the fourth year. U.S.A.I.D. and contractor support will cease after year four.

INTERGOVERNMENTAL FINANCE

Priority 4

Assist the Ministry of Finance in establishing a more rational and transparent system of intergovernmental finance, including clearly defining the spending responsibilities and revenue raising authority of various levels of government.

Intergovernmental finance deals with the assignment of revenue and expenditure responsibilities among the levels of government and to the method of allocating transfers from the center to local government. These items are important for macroeconomic policy and for economic development. Technical assistance should be provided in building governmental capacity to prepare and implement

new intergovernmental financial relationships. The consultant will be provided with a counterpart organization in the Ministry of Finance and expected to prepare that organization to perform intergovernmental finance policy analysis in the assignment of revenue and expenditure responsibilities among the levels of government and in the development, operation, and maintenance formulae for intergovernmental fund transfers. The consultant will be expected to formulate and adhere to a plan for developing the required capacity and for turning all responsibility for intergovernmental financial analysis over to the government.

Priority 5

Assist the local government and democratization program to build political support in local government for increased fiscal decentralization.

As indicated above, intergovernmental finance deals with the assignment of revenue and expenditure responsibilities among the levels of government and to the method of allocating transfers from the center to local government. These items are important for macroeconomic policy and for economic development. The center must be persuaded to give up some of its revenue and expenditure responsibilities. The contract is expected to contribute to a USAID effort to explain to local governments why they need revenue raising and expenditure responsibilities so that they can apply political pressure on the Verkhovna Rada to change the current pattern of assignments.

The consultant will be expected to develop material that explains to local officials why they and their constituents would benefit from increased revenue and expenditure responsibilities. The consultant will work with the USAID local government and democratization program to design and implement a mechanism for disseminating the intergovernmental financial relations material to local governments and politicians. That mechanism should include capability present and explain the material to the local governments and politicians.

INFORMATION SYSTEMS SUPPORT

Priority 6

Provide systems support to complete the Ministry of Finance Intranet information system, including its link to the information system of the Department of Treasury.

The World Bank is providing a loan to the GOU to install an automated accounting system in the Treasury. This system must be linked effectively to the Ministry of Finance budgetary system. Prior consultants have been assisting the Ministry of Finance (MOF) to build an integrated information system for all MOF activities. The consultant will complete the MOF system and ensure that it is effectively linked to the Treasury system.

The consultant will review previous work on the MOF system and the status of the system. The consultant will then prepare a work plan to bring work on the MOF system to a conclusion by the end of the second year. The consultant will share the work plan with consultants assisting the Department of Treasury to ensure that the work plans for both systems are coordinated to produce effective links between the budgeting and accounting systems. The MOF work plan will include all necessary provisions for MOF personnel to operate and maintain the intranet system. The consultant will work

with the MOF project manager to ensure that the work plan accommodates MOF interests and will obtain MOF approval for the work plan within the first six months of the project. The consultant will then execute the work plan, in conjunction with MOF personnel, so that the system is fully operated and maintained by MOF personnel by the end of year two of the project.

PUBLIC ADMINISTRATION REFORM

Priority 7

Design and install a decision-making system in the Cabinet of Ministers (secretariat), the Office of the Prime Minister, and the Office of the President.

Macroeconomic reform requires not only that the good policy alternatives be generated by economic professionals but that a decision-making system be in place that will allow the alternatives to be appropriately processed. Such a system is not now in place. This task is to establish such a system at the top levels of the Ministry of Economy, the Cabinet of Ministers (secretariat), the Office of the Prime Minister, and the Office of the President.

The consultant will interview appropriate personnel of the Cabinet of Ministers (secretariat), the Office of the Prime Minister, and the Office of the President and prepare a report offering the conceptual design for a decision system meeting the need of each organization. The consultant will meet with the project manager and working group of each organization and get agreement on the conceptual design, on a joint work plan for further design and approval, and on permission to proceed. The consultant will assist the working group of each organization to prepare a detailed design for a decision system, including provision for organization structure, staffing requirements, procedures, information requirements, decision calendar, and implementation plan. The consultant will meet with the project manager and working group of each organization and get final agreement on the detailed design and implementation plan. The consultant will assist the working group present the conceptual and detailed designs to top management of each organization for approval, implement the system, and coach in operation of the system, as requested.

Priority 8

Design and install a strategic management system in the Ministries of Economy and Finance.

Reform in the Ministries of Finance and Economy is not complete. These ministers need strategic management systems, that include a strong decision-making component. The consultant is to undertake a comprehensive institutional development effort that includes the design, implementation, and coaching of operations work needed to institutionalize a strategic management system in these two ministries. The institutional design should consider:

- Strategic guidance, including a mission statement and available strategies and policies;
- Organizational structure;
- Staffing plan;
- Systems and procedures;
- Facilities and equipment;
- Budget; and

- External relationships and linkages.

The consultant will interview appropriate personnel of the two ministries and prepare a report offering the conceptual design for a strategic management system meeting the need of each organization. The consultant will meet with the project manager and working group of each organization and get agreement on the conceptual design, on a joint work plan for further design and approval, and on permission to proceed. The consultant will assist the working group of each organization to prepare a detailed design for a strategic management system, including provision for each of the items listed above, and for an implementation plan. The consultant will meet with the project manager and working group of each organization and get final agreement on the detailed design and implementation plan. The consultant will also assist the working group present the conceptual and detailed designs to top management of each ministry for approval, implement the system, and coach in operation of the system, as requested.